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WILLIAM T. WALSH
CLERK

UNITED STATES DISTRICT COURT

DISTRICT OF NEW JERSEY

IN RE: AT&T CORPORATION SECURITIES LITIGATION

Master File No. 3:00cv05364

CLASS ACTION

Judge Garrett E. Brown, Jr.
Magistrate Judge John J. Hughes

CONSOLIDATED AMENDED COMPLAINT FOR VIOLATION OF THE SECURITIES EXCHANGE ACT OF 1934

DEMAND FOR JURY TRIAL

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INTERNATIONAL BROTHERHOOD OF ELECTRICAL WORKERS LOCAL 98, THE NEW HAMPSHIRE RETIREMENT SYSTEM, ROBERT BAKER, MOHAMMED AND MAULINE KARKANAWI and SECURE HOLDINGS, INC., On Behalf of Themselves and All Others Similarly Situated, Plaintiffs, vs. AT&T CORPORATION, C. MICHAEL ARMSTRONG, CHARLES H. NOSKI, RICHARD R. ROSCITT, JOHN D. ZEGLIS and DANIEL E. SOMERS, Defendants.	Master File No. 3:00cv05364 CLASS ACTION Judge Garrett E. Brown, Jr. Magistrate Judge John J. Hughes CONSOLIDATED AMENDED COMPLAINT FOR VIOLATION OF THE SECURITIES EXCHANGE ACT OF 1934
In re AT&T CORPORATION SECURITIES LITIGATION	
This Document Relates To: ALL ACTIONS.	DEMAND FOR JURY TRIAL

TABLE OF CONTENTS

Plaintiffs allege:

INTRODUCTION AND OVERVIEW

1. This is a class action on behalf of all purchasers of the common stock of AT&T Corporation ("AT&T" or the "Company") between 10/25/99 and 5/1/00. On 11/1/97, C. Michael Armstrong ("Armstrong") became the Chairman and CEO of AT&T succeeding Robert Allen, under whose leadership AT&T's business had performed poorly and suffered slowing growth and as a result of which AT&T's stock fell to as low as $20 in early 97. It was widely perceived that AT&T's future was endangered by the lack of a viable growth strategy in the rapidly evolving telecommunications industry. This caused widespread concern among AT&T's shareholders – which included hundreds of thousands of individuals and virtually all major institutional investors. Armstrong was to remedy this very disturbing situation.

2. Armstrong implemented dramatic steps to try to accelerate AT&T's revenue growth and improve its profitability – attempting to transform AT&T from a staid, low-growth long-distance carrier into a diversified, rapidly growing telecommunications giant that would effectively and efficiently deliver bundled telecommunications services (digital cable television, high-speed Internet access, local and long-distance telephone, data transmission and wireless communications). To achieve these goals, Armstrong pursued a combination of huge cost cuts – achieved via the layoff or induced retirements of thousands of experienced and highly compensated white-collar and management employees – and an extraordinarily expensive acquisition spree to diversify AT&T into high-growth areas such as cable and broadband. By mid-99, Armstrong had cut billions of dollars of overhead – eliminating over 20,000 white-collar positions – and spent over $140 billion on several acquisitions (Teleport Communications, TeleCommunications, Inc. ("TCI"), IBM's Global Network and MediaOne) by having AT&T issue hundreds of millions of new shares of its common stock and incur over $60 billion in debt. However, because the cable systems AT&T acquired were antiquated, AT&T also had to pursue a massive multi-billion dollar upgrade of these cable systems, the so-called

cable upgrade or broadband build-out,[1] to create a technologically advanced broadband system capable of two-way interactive communications, which was a key ingredient of AT&T being able to effectively and efficiently deliver bundled telecommunications services to customers.[2] AT&T also announced the formation of a huge joint venture with British Telecommunications ("BT") called Concert, which was to be the core of AT&T's very profitable international long-distance business and global growth strategy going forward.

3. Armstrong explained this strategy in AT&T's 98 Annual Report, issued in 3/99, stating:

> We're transforming AT&T from a long distance company to an "any-distance" company. From a company that handles mostly voice calls to a company that connects you to information in any form that is useful to you – voice, data and video ... to a truly global company.
>
> * * *
>
> The future is a digital, broadband world. Broadband systems transmit data at high speeds that make advanced communications services work. The AT&T long distance

---

1 Broadband is a communications channel with wide bandwidth that enables it to carry more information at higher speeds than a narrowband channel. A broadband system can transmit many different signals at the same time. Each set of signals is translated into frequencies that do not interfere with one another.

2 AT&T explained its broadband build-out in its 98 Annual Report:

> Someday soon, a truck [from AT&T] may rumble down your street, stop in front of your house and make a delivery [of a] dazzling bundle of communications services carried on a ribbon of broadband cable.
>
> Through our merger with TCI and agreements with five of its affiliates and Time Warner, we'll soon have access to broadband cable facilities that pass 43 million U.S. homes. That's a direct link to 40 percent of households in the country, creating the nation's most extensive, broadband local network platform.
>
> The current copper telephone wire to most homes carries phone conversations at thousands of bits per second. But broadband cable zips information, voice and video at millions of bits per second.
>
> * * *
>
> Over the next few years, millions of families will be able to connect phones, computers and televisions to that cable. In addition to high-speed Internet access, digital-quality video and CD-quality audio, they'll have multiple lines of any-distance telephone service – including local – with conference calling, call waiting, call forwarding and individual message centers for family members.
>
> Even the cable box on their TV will be set to deliver. Not only will it let them order pay-per-view movies, it will become a virtual communications center ....

network has been broadband for years, but the final connections to most customers are still pairs of copper wires that carry a narrow stream of information, fine for voice calls but too slow for the services in our future.

* * *

Our customers, especially multinational companies, need end-to-end global services with consistent quality, price and customer support. To provide that, AT&T has a facilities-based global strategy that gives customers the same technology and support everywhere in the world. That's why we announced our plans for a global joint venture with BT and acquired the IBM global network.

* * *

As we make these changes for the future, we've also accomplished some ambitious short-term goals. In 1998, we took $1.6 billion in costs out of the business and surpassed our two-year goal of an 18,000-person reduction in the workforce in just one year.

* * *

For AT&T in 1999, the big challenge is to execute the strategy we've put in place. ***We have the strategy. We have the assets. And we have the people.***

4. As a result of early investor enthusiasm for Armstrong's makeover of AT&T, AT&T's stock climbed to over $64 by early 99, making stock options to purchase hundreds of thousands of shares of AT&T stock at between $40.95-$59.87 that had recently been granted to AT&T's top executives (as detailed in ¶45(f)) worth many millions of dollars to each of them. However, by mid-99, investor enthusiasm for Armstrong's transformation of AT&T began to sour. Some analysts voiced fears that AT&T's dramatic steps were not only not sufficiently spurring AT&T's growth and profitability in the short term, but that AT&T might never recover these huge diversification investments. Because of AT&T's acquisition spree, the number of AT&T common shares outstanding had ballooned to over 3.2 billion – raising the specter of serious ongoing earnings dilution. This, coupled with AT&T's vastly increased debt load and its need to spend billions of dollars to upgrade its cable and wireless assets, made the prospects for AT&T achieving substantial profit growth – at least in the near term – uncertain. In fact, during 99, AT&T's revenue growth slowed, its earnings per share ("EPS") declined and, in 8/99, ***AT&T told analysts to lower the 99-00 revenue growth forecasts for AT&T.***

5. By the Fall of 99, investors and analysts realized that despite AT&T's diversification initiatives, AT&T's ability to accelerate its revenue growth and increase its EPS, at least during 00-

01, remained very much dependent upon the performance of AT&T's core long-distance business, which still provided some 70% of AT&T's revenues and profits. While AT&T's ***consumer*** long-distance business was suffering revenue declines due to intensive price competition, AT&T's ***business*** long-distance operations (especially international business long distance) were still achieving revenue growth and were highly profitable. AT&T's business long-distance operations (domestic and international) were conducted by its Business Services unit – ***AT&T's largest single business unit, which alone provided about $28 billion in annual revenue, about 50% of AT&T's total revenues and more than 50% of its profits***. According to *The Wall Street Journal*, "***Business Services is what investors have been counting on to support AT&T as it invests heavily to build up its fast-growing, but still money-losing cable and wireless units.***" To try to accelerate the growth of AT&T's international long-distance business, AT&T had formed a huge new joint venture with BT – ***Concert*** – to focus on furnishing communications services (voice and data transmission) to large multi-national corporate customers. Concert was described by AT&T as follows:

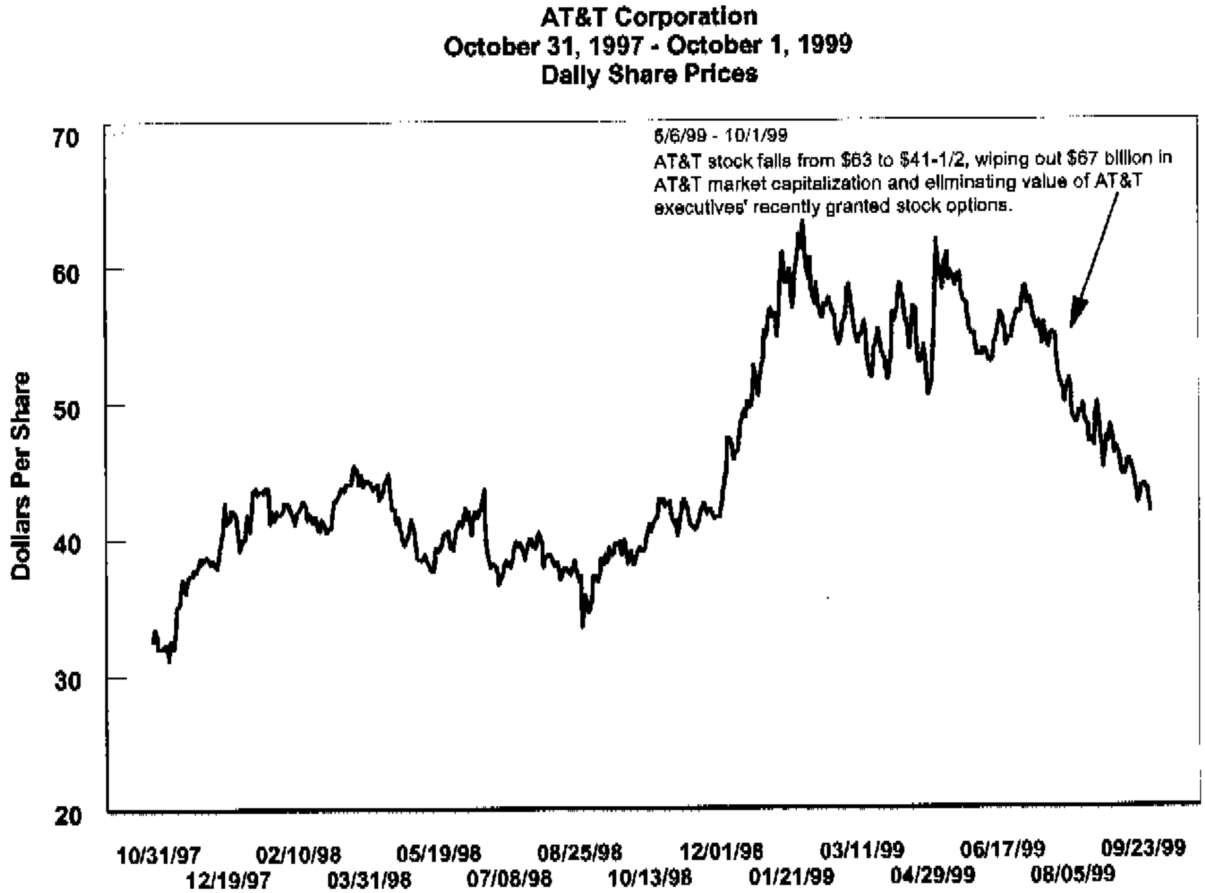
> ***Concert represents the core of AT&T's global strategy and will serve multi-national business customers, international carriers, and Internet service providers.***

Concert began operations in 10/99. The reason why AT&T's global business long-distance operations were so important was explained by an 11/5/99 Prudential Securities report:

> AT&T's global strategy is coming into place with the final approvals for its joint venture with British Telecom.... To maintain large business customers, carriers have to be able to serve those customers around the world. ***Winning in the large corporate market is key for two reasons – scale and growth.***
>
> These customers bring significant volumes to the table which helps spread fixed costs over a large base, lowering overall unit costs. Moreover, these companies are among the most intense users of data services, the fastest growing segment of the telecom industry.

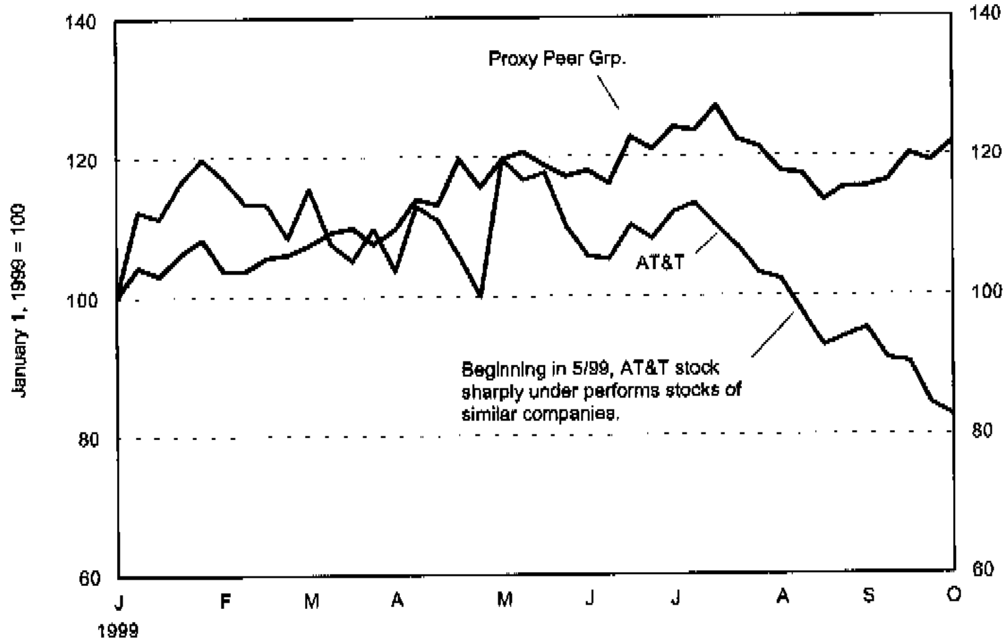
6. However, during the 2ndQ and 3rdQ 99, AT&T's business long-distance revenue growth had slowed to 7% in the 2ndQ and then to 5% in the 3rdQ. Partly as a result, AT&T reported disappointing 3rdQ 99 results and slowing overall revenue growth (5% down from 7%) and ***declining*** EPS. ***The slowing growth of the largest and most profitable operating unit of AT&T's business was very disturbing to investors and AT&T stock declined sharply to as low as $41-1/2 by 10/1/99***. This precipitous decline, ***which wiped out $67 billion in shareholders' market***

capitalization and completely wiped out the value of the AT&T executives' stock options to purchase hundreds of thousands of AT&T shares that had been granted during 98 and earlier in 99 at $40.95-$59.87 per share, is shown below:



As a result of this decline, AT&T's stock ***dramatically*** under-performed the stocks of comparable companies during 99, as shown below:

AT&T Corp.
vs. Proxy Peer Group (1)
January 1, 1999 - October 1, 1999



(1) Equally weighted group consisting of BEL, GTE, SBC, USW, HKT, WCOM, FON, VOD, CMCSA & CVC.

Because of the widespread ownership of AT&T common stock and the prominence of AT&T, these events were the source of extensive negative media coverage of Armstrong and AT&T in 8/99-10/99 and caused great concern among AT&T's individual and institutional shareholders, as well as embarrassment to Armstrong, as they threatened his continued tenure as AT&T's Chairman/CEO.

7. By 8/99-10/99, Armstrong and his top AT&T management team found themselves in a dangerous and disturbing situation. AT&T's huge acquisition of MediaOne, which had been agreed to in 4/99 when AT&T's stock was trading at $57, had been accomplished only when AT&T had won a bitter bidding war by agreeing to a very risky price guarantee, providing that if AT&T's stock fell below $57 and to as low as $51, ***AT&T would have to pay up to an additional $3.6 billion in cash to MediaOne's shareholders***, which Armstrong knew would make the MediaOne acquisition uneconomical. Unfortunately, AT&T's efforts to close its acquisition of MediaOne earlier in 99 when its stock price was over $57 failed due to regulatory delays and it appeared that AT&T would not be able to close the MediaOne acquisition until the 1stQ 00. The precipitous decline of AT&T's

stock in the Fall of 99, when the stock fell to as low as $41-1/2 on 10/1/99, triggered the huge $3.7 billion AT&T cash payment guarantee on the MediaOne acquisition. This placed tremendous pressure on AT&T's top executives to push AT&T's stock back up, hopefully above $57 per share during the 1stQ 00 – when AT&T now hoped to close the MediaOne acquisition. In addition, by the Fall of 99, AT&T's huge debt load plus the huge cable upgrade/broadband build-out costs were placing a real financial strain on AT&T, which its top executives realized was facing impending cash flow problems. To raise desperately needed new capital, AT&T's top executives had decided to undertake a huge initial public offering ("IPO") for a new class of AT&T common stock, a "tracking stock" for AT&T's Wireless unit, to the public. If successful, this IPO could generate over $10 billion of badly needed new capital for AT&T. They also hoped the IPO would create a new and valuable "currency" for AT&T which AT&T could use to raise additional capital and use to help fund its ongoing acquisition spree, as the poor performance of AT&T's existing common stock had reduced its attractiveness as a currency to use for acquisitions. AT&T's executives also believed the public sale of the Wireless tracking stock would boost AT&T's common stock by helping quantify and solidify the "sum of the parts" valuation of AT&T, which many securities analysts engaged in and which ***Armstrong insisted to investors and analysts alike yielded a value of $79 per AT&T common share***! However, in order to push AT&T's stock price back up higher (as the performance of AT&T's stock would directly impact the IPO price of AT&T Wireless tracking stock) and successfully complete this tracking stock IPO (***which was to be the largest domestic IPO in history*** – 360 million shares at $29-$30) it was imperative that both AT&T's Wireless unit and AT&T's overall business (of which AT&T Wireless was a key part) ***appear to be performing well.***

8. Thus, Armstrong and the other top AT&T executives commenced a campaign to boost the price of AT&T common stock, making statements to boost the price of AT&T's stock in connection with, in contemplation of, and to further the Wireless tracking stock IPO they were then planning. Beginning in late 10/99, when AT&T reported its 3rdQ 99 results on 10/25/99, AT&T executives told analysts and large AT&T institutional investors that AT&T was ***improving its business long-distance competitive position, was keeping its business long-distance customers and that it was seeing continued strength in international long distance and data transmission***, an area

of its business where it had made lots of progress during 99. However, AT&T also reported a net Wireless subscriber gain of only 269,000 – far less than the 450,000-500,000 forecast. But AT&T attributed this to one-time events – ***a deliberate decision by AT&T to reduce marketing efforts in some major markets that were capacity constrained and cellular handset shortages*** – assuring analysts that these problems ***had been fixed, full-scale marketing had resumed, its Wireless subscriber base was of 'high quality," the Wireless business was not suffering excessive "churn"***[3] ***and was well-positioned for a large acceleration in net adds/new subscribers in 4thQ 99, which would exceed the 437,000 new customers added in 4thQ 98***. AT&T also assured analysts and investors that its huge cable upgrade/broadband build-out project was ***on schedule and succeeding and on budget and achieving a lower per-house cost than forecast***. Thus, they told analysts as a result of all this, ***AT&T's transformation into a global telecommunications conglomerate which could deliver bundled telecommunications services was succeeding***. During 11/99, AT&T told analysts that it was going to present extremely favorable information about its business – ***especially its Business Services operations*** – as well as its cable upgrade/broadband build-out and wireless operations at AT&T's upcoming 12/6/99 analysts' meeting, including forecasting ***accelerating*** revenue growth for AT&T's vitally important business long-distance operations, in part due to its new Concert joint venture, and that, as a result, AT&T overall would achieve ***accelerating revenue and EPS growth*** in 00. As a result, after trading as low as $42-3/4 on Friday, 10/22/99 – the last trading day before AT&T reported its 3rdQ 99 results on 10/25/99 – AT&T's stock advanced strongly, reaching $52 by 11/22/99. Then, during late 11/99, as it became known that Salomon analyst Jack Grubman – the most influential telecommunications analyst on Wall Street, ***and a long-time bear on AT&T*** – had been meeting with Armstrong and AT&T's other top executives, was re-evaluating his opinion on AT&T and ***was preparing a new, positive report on AT&T, AT&T's stock climbed to $61 per share.***

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[3] "Churn" refers to a lost wireless customer. Excessive wireless "churn" decreases average revenue per customer, average customer life and raises the cost of achieving net subscriber gains – adversely impacting the economics of a wireless business.

9. On 12/6/99, AT&T held its most highly attended analysts' meeting in history – an all-day presentation by AT&T executives at the Waldorf Astoria ***for 800 analysts***! The presentation by AT&T's top executives was extraordinarily upbeat and bullish. During the meeting, they told analysts that AT&T's new Concert joint venture for worldwide long-distance business services ***had now been successfully launched*** – taking over some 300 of AT&T's largest international corporate accounts – and that, as a result of ***a successful reorganization and re-staffing of AT&T's Business Services unit and internal re-alignment of over 1,200 major accounts to that "high growth" unit, AT&T was now forecasting an acceleration in Business Services revenue growth to 11% during 00 – compared to 7% in 99***. This forecast of accelerating revenue growth in AT&T's largest and most public business unit was a key component of AT&T increasing its overall corporate revenue growth forecast to 8%-9% for 00, compared to 6%-7% in 99. ***Because AT&T had over $53 billion in annual revenues, these upward adjustments in revenue growth were extremely material, as they involved AT&T's most important and most profitable business unit and thus overall amounted to billions of dollars of additional revenue – and hundreds of millions of dollars of greater profits***. AT&T also stressed ***the resumption of a strong subscriber growth rate for its Wireless business after the 3rdQ 99 slowdown, indicated that wireless subscriber "churn" was not a problem and assured analysts and investors that its cable upgrade/broadband build-out project was on schedule and on budget*** – thus AT&T's bundled services strategy was succeeding.

10. The 1/10/00 edition of *Fortune*, published in late 12/99, detailed the dramatic turn of events caused by AT&T's 10/99-12/99 publicity campaign and its extremely bullish 12/6/99 analysts' conference:

> ***Mike Armstrong's been winning over Wall Street with a good-news offensive....***
>
> On Dec. 6, AT&T chief Michael Armstrong stood before 800 telecom analysts in New York's Waldorf Astoria ballroom ***and put the crowning touch on his months-long campaign to revive the company's sagging stock price***. AT&T, said Armstrong, would indeed create a tracking stock for its hot wireless-phone business, raising several billion dollars through an initial public offering .... The news, which already had been carefully leaked to the press during Thanksgiving week, boosted the shares ....
>
> The wireless announcement followed an earlier coup by Armstrong. The previous week, he had finally talked one of telecom's most influential analysts, Jack Grubman at Salomon Smith Barney, into ending his four-year bearishness on the

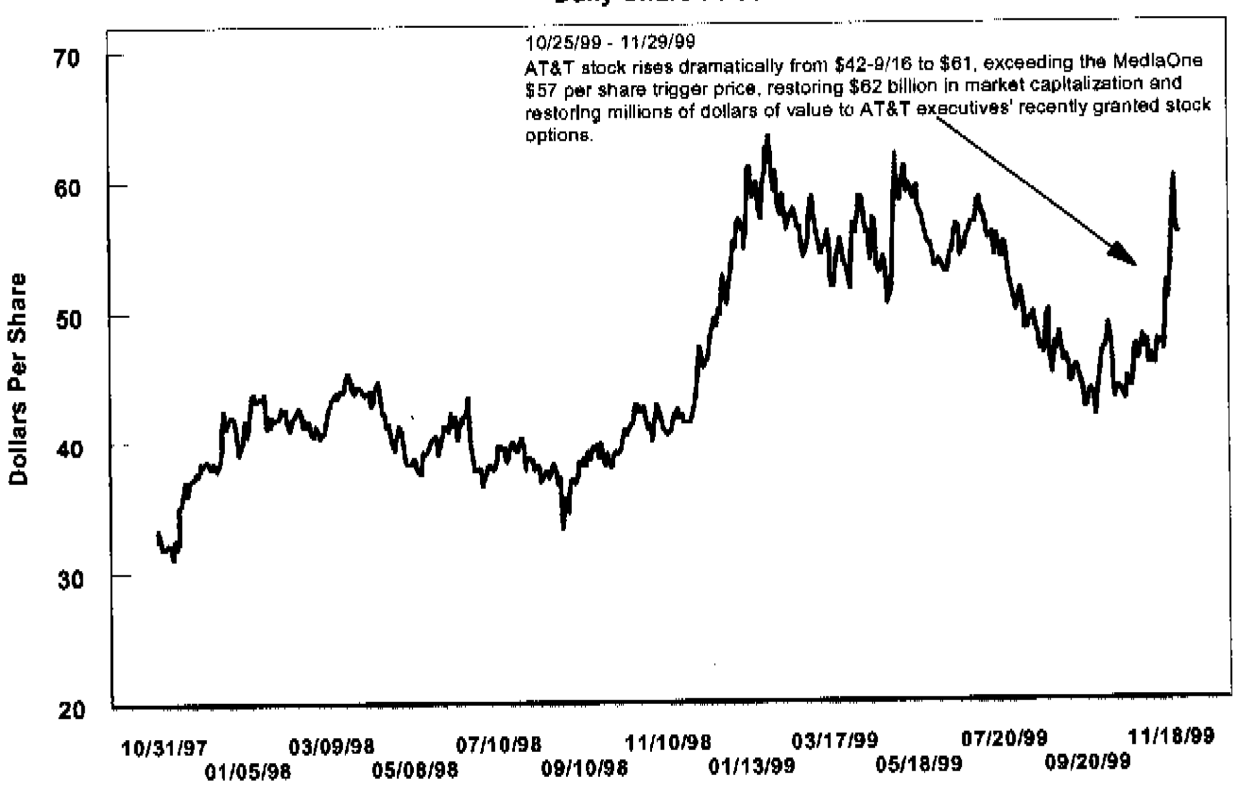
stock and issuing a "buy" recommendation.... ***Echoing AT&T's own analysis, Grubman concurred that the company could get annual returns on its cable properties approaching 30%, more than twice its cost of capital.*** On Nov. 29, the very day the report hit the streets, a happy Armstrong told FORTUNE that "***the thing I like about Jack's report is, he talked about the fundamentals of the company, rather than just speculation about the Wireless tracker. It helped [our stock] quite a bit today.***" Indeed the buzz generated by the tracker stock and the Grubman report has boosted AT&T shares to the mid-50s after a disastrous five months in which they fell from the low 60s to the low 40s. ***And as it happens, the recent run turns out to be just enough to save AT&T more than $3 billion on its MediaOne deal, which it expects to close in the first quarter of 2000.***

* * *

Until [Armstrong decided on the Wireless tracking stock IPO] doubts about the cable strategy had threatened to cost AT&T an extra $3.6 billion on its MediaOne acquisition, which requires AT&T to pay MediaOne shareholders extra cash if the price of its stock falls below $57 within a few weeks of the close of the deal. On the day news of the tracker stock appeared in the *Wall Street Journal*, AT&T shares shot up 12%, to just over $52, their biggest one-day move in a decade. ***The tracker not only helped AT&T dodge that $3.6 billion bullet, but it also muzzled Wall Street's criticism of the cable strategy.***

11. The sharp recovery in AT&T stock after its earlier precipitous decline is shown below:

AT&T Corporation
October 31, 1997 - December 1, 1999
Daily Share Prices



This sharp price recovery in AT&T stock regained almost 100% of the $67 billion in market capitalization wiped out by the decline in AT&T's stock in 8/99-10/99, pushed AT&T stock over the $57 per share level necessary to avoid the $3.6 billion MediaOne payment and restored millions of dollars of value to the recently granted stock options to the top AT&T executives.

12. On 1/25/00, AT&T reported its 4thQ 99 and 99 results, and Armstrong and AT&T's other top executives also had communications with securities analysts and investors. AT&T's top executives reaffirmed the representations and forecasts they had made at AT&T's 12/6/99 analysts' conference and assured analysts and investors that:

- AT&T was confident that its revenue growth was going to continue to accelerate.
- Strong pipeline and new General Motors and Acer contracts assured Business Services will grow at 9%-11% in 00.
- After a deliberate pause in the 3rdQ 99, Wireless marketing was back to full strength. AT&T's Wireless unit was achieving strong subscriber growth with 440,000 net adds in the 4thQ 99 – its best 4thQ ever and its best December for net adds ever – allowing it to forecast 20%+ subscriber growth in 00.
- While AT&T did not disclose its "churn" rate, its churn rates were generally in line with the industry and, on the digital side, a little better than the industry.
- While AT&T had encountered slightly higher than anticipated broadband build-out costs, the broadband build-out was roughly on-track and on budget – with a unit cost slightly less than planned – proceeding a little ahead of schedule and successfully, encountering very strong consumer demand for AT&T's resulting bundled telecommunications services.
- Business Services' revenue grew 8.5% in the 4thQ 99, ***slightly*** below the 9%-11% increase forecast for 00. ***However, better sales execution and a strong pipeline of business due to new multi-year contracts would enable Business Services to grow its revenue by 9%-11% during 00.***
- AT&T was still forecasting 00 EPS of $2.10-$2.15, even though 1stQ 00 EPS would be slightly less than earlier forecast due to higher than anticipated wireless and cable upgrade costs.

13. The statements made by AT&T's executives during 10/99-1/00 about AT&T's Concert joint venture, AT&T's Business Services corporate long-distance segment, AT&T's Wireless operations, AT&T's cable upgrade and broadband build-out and AT&T's accelerating revenue and EPS growth were false.

(a) As detailed in ¶¶48-64, as part of AT&T's cost-cutting drive during 98 and 99 and the reorganization of AT&T's Business Services operations, AT&T had eliminated or transferred several thousand experienced multi-national corporate account service representatives and sales personnel at the same time that it had transferred 300-500 major corporate customers to Concert and 1,200 very large corporate accounts internally to its "high growth" Business Services unit. ***These transfers of AT&T's most important corporate accounts, combined with the elimination of a large number of corporate account sales and service representatives, was a disaster, resulting in serious sales and customer service problems.*** The lack of sufficient experienced account service representatives and sales personnel caused important large international corporate customers to be neglected and poorly served. Many large international corporate long-distance customers were enraged over these service and sales failures and told AT&T they would abandon or were abandoning AT&T's long-distance (voice and data transmission) business, resulting in the loss of many major international long-distance customers, including Pepsi, Chase Manhattan, Bank of New York, SuperValue Inc., Paper Mart and G&A Sales, and the impairment of AT&T's competitive position in the business long-distance market – especially the international market. These problems also resulted in a rapid erosion of AT&T's low-speed private-line business and a sharp slowdown in its wholesale voice revenues, which were dependent on this same customer base. These problems in AT&T's key Business Services unit were exacerbated by AT&T's loss during 99 of two large U.S. government long-distance contracts (the FTS 2000 contracts) and a huge ($650 million per year) BP Amoco PLC contract, which kicked in in late 99 and early 00, depriving AT&T of millions of dollars of previously in-place revenues. As a result of these negative factors, Armstrong and AT&T's top executives knew by 10/99 that AT&T's Business Services unit's revenues would be materially adversely affected, as AT&T had not successfully replaced the hundreds of millions of dollars in annual yearly revenues lost due to the FTS 2000 and BP Amoco contracts, and its Business Services revenues would be hurt by large corporate multi-national customer defections then occurring, which would result in the loss of many large long-distance contracts during the 1stQ 00. ***Due to these negative factors, AT&T and Armstrong knew by 10/99 that the representations about AT&T's increased competitiveness, the success of AT&T's Concert joint venture and its business long-distance service and the accelerating***

revenue growth of AT&T's Business Services division were false. This knowledge was confirmed by catastrophically poor 1/00 results from the Business Services unit, which were followed by even worse 2/00 and 3/00 results. Also, by late 1/00 or early 2/00, AT&T's Business Services corporate long-distance operations had deteriorated so seriously that AT&T was in the process of ***replacing several of the top managers in that Business Services unit in an effort to correct the problems being encountered there -- which was resulting in the loss of significant numbers of important corporate customers.*** And the reason for the slight shortfall in revenue growth in AT&T's Business Services unit during the 1stQ 00 was the undisclosed debacle in AT&T's Business Services unit – ***not*** higher than anticipated wireless and cable upgrade costs as reported.

(b) The statements about the broadband build-out were false and misleading because AT&T's broadband build-out for its cable operation was significantly behind schedule and over budget due to the technical difficulties and other problems being encountered, as detailed in ¶¶65-68.

(c) The statements about AT&T's success in delivering bundled telecommunications services were false and misleading because AT&T's attempt to deliver bundled services of digital cable TV, high-speed Internet access, data transmission, long-distance and local telephone and wireless communications services was failing and could not be achieved due to AT&T's inability to successfully integrate the acquisitions it had made over the prior few years and its inability to efficiently and effectively deliver bundled services, as detailed in ¶¶69-84.

(d) These statements were also false and misleading due to the failure to disclose that AT&T's top executive team was planning to break-up AT&T into three or four separate companies after the AT&T Wireless tracking stock IPO was completed, as described in ¶94.

14. As Armstrong and AT&T's other top executives were going on their campaign to boost AT&T's stock price in 10/99 and were finalizing their plans to announce the huge AT&T Wireless tracking stock IPO, they encountered a very serious problem in the AT&T Wireless unit – a sharp drop off in new subscriber growth. Since the AT&T Wireless unit was viewed as AT&T's growth engine, a slowdown in Wireless subscriber growth was a very alarming development, as continuing strong growth in subscribers was ***the key metric*** analysts used to forecast future revenue growth for

AT&T Wireless upon which AT&T's consolidated revenue growth was largely dependent. In order to conceal the true adverse consequences of this development, when AT&T reported its 3rdQ 99 results on 10/25/99 and revealed that during the 3rdQ AT&T Wireless had obtained only 269,000 net adds, or new subscribers, far below the 450,000-500,000 anticipated, AT&T told analysts that the shortfall was due to a ***deliberate decision by AT&T to curtail marketing activity in key markets because AT&T Wireless was capacity-constrained in those markets*** and also due to such other temporary and one-time events as a shortage of cellular phones. AT&T also represented that these one-time problems were behind it, aggressive marketing had resumed, subscriber growth was again back on track and ***that AT&T Wireless anticipated obtaining at least 437,000 new subscribers in the 4thQ 99.*** These representations were indispensable to supporting AT&T stock and to the pricing of the AT&T Wireless tracking stock IPO, which AT&T's executives knew would take place in the Spring of 00.

15. However, these representations about AT&T Wireless were false. AT&T Wireless had suffered the sharp drop-off in new subscribers because AT&T Wireless service in several markets was so terrible that customers were refusing to sign up for the service, in part due to problems with AT&T's inferior TDMA cellular technology. In addition, AT&T Wireless' service in many markets was very poor, with excessive line static and call cut-offs, and its billing problems were notoriously bad, resulting in customers canceling the service and others refusing to sign up for it, which, in combination, led to reduced net adds or new net subscribers. Due to poor service, billing mistakes and inferior technology, AT&T Wireless was encountering excessive "churn," *i.e.*, ***the worst in the industry, which greatly increased the cost of achieving new adds or net new subscribers, which was adversely impacting AT&T's Wireless unit's results.*** However, AT&T did not dare disclose these adverse facts. ***So instead, in addition to lying about the reasons for the decline in Wireless subscriber growth in the 3rdQ 99, in 10/99 AT&T Wireless began what was known as the transfer of authorization ("TOA") scam, detailed below at ¶¶85-91, by which Wireless sales management and Wireless sales personnel created bogus new subscriber accounts to boost AT&T Wireless' reported subscriber growth, so that AT&T Wireless would be able to report 4thQ 99 subscriber growth of over 437,000 new subscribers and 1stQ 00 new subscriber growth of at least 400,000 new***

subscribers – which numbers would be reported early in 00, just as efforts to complete the Wireless tracking stock IPO kicked into high gear and, in 4/00, just before the Wireless tracking stock IPO was priced!

16. By 11/99, Armstrong's efforts to transform AT&T into a global telecommunications conglomerate that could deliver bundled services of local and long-distance phone service, high-speed Internet access, data transmission and digital cable TV via technologically advanced two-way broadband technology was failing badly. The cable upgrade/broadband build-out project was plagued by technical difficulties and was behind schedule and over budget. AT&T had failed to successfully integrate the several acquisitions it had made in recent years and, as a result, was unable to provide customers with single-point sales, service or billing. AT&T's international business long-distance business was suffering horrible operational and service problems resulting in the loss of many large multi-national customers and huge revenue shortfalls. Finally, AT&T's Wireless unit was not nearly as successful as claimed, due to service and technical difficulties there as well, which was resulting in excess "churn" and a slowdown in subscriber growth. ***Thus, by 1/00, Armstrong and AT&T's other top executives were discussing completely reversing strategy and breaking up AT&T into separate operating companies, a development they knew the market would view as very negative – an admission of failure. By 2/00, the problems had continued to worsen to the point where Armstrong and AT&T's other top executives realized that breaking up AT&T was inevitable and they were preparing submissions to the Board of Directors to approve pursuit of that reversal of strategy.*** However, Armstrong's acquisition binge had resulted in AT&T's debt ballooning to over $62 billion and, by late 99, AT&T was facing impending cash flow problems. Thus, it was imperative that AT&T find some way to raise billions of dollars of new capital. The only feasible vehicle to obtain this capital was a public offering of the AT&T Wireless tracking stock. However, if AT&T reversed its bundling strategy and disclosed its intention to break up into four companies, the failure of Armstrong's strategy to transform AT&T so it could deliver bundled services would become evident, AT&T's stock price would fall ***and the price of any Wireless IPO would be adversely affected.*** And, if Armstrong and AT&T's top executives broke up AT&T prior to that IPO occurring, then ***AT&T would not be able to get its hands on the IPO proceeds.*** Therefore, in order to

successfully complete the AT&T Wireless tracking stock IPO and raise the billions of dollars in new capital AT&T so badly needed, Armstrong and AT&T's other top executives concealed their plan to break up AT&T into separate companies and continued to misrepresent the purported success of their strategy to transform AT&T into a global telecommunications conglomerate which could effectively and efficiently deliver bundled telecommunications services. In fact, after the AT&T Wireless IPO, and ***notwithstanding assurances in the Wireless IPO prospectus that most of the AT&T Wireless IPO proceeds would be used only for expansion of the Wireless business, AT&T took possession of most of the IPO proceeds to use them for AT&T's general corporate purposes***! And, just as Armstrong and AT&T's other top executives feared would occur, on 10/25/00, when AT&T ultimately did disclose that it was breaking up into four companies, AT&T's stock fell from $25-3/4 to $21-5/8 and the AT&T Wireless tracking stock fell from $23-7/8 to $20-1/4, *i.e.*, ***both stocks falling by just over 15%, due to this negative disclosure.***

17. In mid/late-3/00, AT&T issued its 99 Annual Report to Shareholders. The report began by stating "***now we're delivering results***" and "***[w]e're creating a new AT&T to bring a new generation of communications and information services to people's homes and businesses,***" and included a letter signed by Armstrong that stated:

> ***AT&T is successfully transforming itself from a domestic long distance company to an any-distance, any-service global company.***
>
> ***That was the promise of my last annual report to you, and I'm proud to report that we are delivering on that promise.***
>
> ***We've made the right strategic decisions, invested in the right assets and have the right people to get the job done.***
>
> ***In 1999 ... [w]e began operation of Concert, our joint venture with BT, to better serve multinational corporations around the world.***
>
> * * *
>
> ***We also upgraded more than half our cable plant – just as we said we would – and at a slightly lower cost per household than we originally estimated.***
>
> * * *
>
> The people of AT&T are demonstrating that our strategy is not just doable – ***it's being done.***
>
> * * *

> *AT&T is gaining momentum. Our strategy for growth has us on the right track. Our record of meeting commitments is quickening our pace. My millennium message: There's no stopping us.*

Elsewhere, AT&T's 99 Annual Report stated: "AT&T Wireless Services is our fastest growing business, ***with a 33 percent increase in subscribers***," "***AT&T Broadband is on track and gaining momentum***," and "***[w]e're upgrading the broadband cable assets we acquired for two-way communication. That upgrade is ahead of schedule and on budget***." These statements were false and misleading for the reasons stated in ¶¶13-16.

18. As a result of the favorable statements about AT&T's business issued during the Class Period to date, by 3/29/00, AT&T stock traded at $61, ***above the critical MediaOne $57 guarantee level*** which would enable AT&T to save $3.6 billion if it could keep its stock above $57 when it was able to close the MediaOne transaction in the near future. This stock price increase had also restored millions of dollars in value to the stock options granted to AT&T's top executives during 98-99, as detailed in ¶45(f)

19. AT&T wanted to complete the Wireless tracking stock IPO in 4/00. However, during 4/00, the U.S. securities markets became very volatile and suffered significant declines – especially in "high-tech" stocks. By mid-4/00, many IPOs had been canceled. However, AT&T was determined to complete its Wireless tracking stock IPO because AT&T knew it could not conceal much longer that its 1stQ 00 results had been disappointing due to the debacle in its Business Services unit, which would expose its reduced 00 revenue growth rates. These unsettled market conditions made it even more imperative that AT&T assure investors of the health and success of its core Business Services corporate long-distance operations – so that AT&T common stock would hold up well during this critical period – and of strong subscriber growth in AT&T's Wireless unit as AT&T attempted to complete the largest IPO in history ***and***, at the same time, was trying to get the MediaOne acquisition closed.

20. During the first three weeks of 4/00, AT&T's top executives conducted an extensive "Roadshow" to create investor enthusiasm for the Wireless tracking stock IPO, during which they held 72 one-on-one meetings with institutional investors in 26 cities, 24 group gatherings and five conference calls during which they continued to misrepresent and overstate the rate of Wireless new

subscriber growth while concealing the TOA activity, as well as the serious problems in AT&T's Business Services unit and that AT&T's recent forecasts of accelerating revenue and EPS growth were false and would not be achieved.

21. AT&T's promotional efforts for the Wireless IPO included the release, on 4/3/00, just as the Roadshow started, and on 4/24/00 – just three days before the IPO – of positive 1stQ 00 financial data for AT&T's Wireless unit. AT&T's 4/3/00 release stated "***Net wireless subscriber additions are expected to exceed 400,000 for the first quarter***." The 4/24/00 release stated: "***Net subscriber additions totaled 418,000 as compared to 372,000 in the first quarter of 1999***." These statements were false, as the AT&T Wireless new subscriber numbers were inflated due to the TOA scam, as detailed in ¶¶85-91.

22. Due to AT&T's sophisticated financial and accounting systems, AT&T was able to preliminarily determine its quarterly results within 24-48 hours after the end of the quarter and release its quarterly results in 14 business days after the end of the quarter in question. With respect to AT&T's 1stQ 00, AT&T completed the "quarter close" and was prepared to release its financial results by 4/18-19/00, at which time it would normally have reported its 1stQ 00 financial results and had discussions with analysts regarding those results, as well as the overall condition of and trends in AT&T's business. However, AT&T's top executives knew that, as a result of the debacle in AT&T's Business Services segment and its loss of large government contracts, AT&T was going to report slower than forecast 1stQ 00 revenue growth and lower than previously forecast 1stQ 00 EPS and would have to reveal ***not only its Business Services debacle, but that due to that debacle, AT&T had to lower both its business long-distance revenue growth forecast and its overall corporate revenue growth forecast after it had just raised both of those significantly at the 12/6/99 analysts' meeting***! AT&T's top executives knew that disclosing this negative information at the time that AT&T was attempting to complete the huge Wireless tracking stock IPO amid tumultuous market conditions would be a disaster. Such disclosure would result in a precipitous drop in AT&T's common stock price. This, in turn, would cut the IPO price of the 360 million shares of AT&T Wireless tracking

stock by several dollars per share, if not result in the cancellation of that IPO,[4] especially given the disrupted condition of the IPO market at that time. Thus, even though AT&T's 1stQ 00 results were ready for release by 4/18-19/00, ***AT&T's top executives deliberately concealed and delayed the release of those results to avoid disclosing the adverse information about AT&T's Business Services unit which they knew would accompany those 1stQ 00 results, so that AT&T could complete the important Wireless tracking stock IPO before this negative information became public!***

23. On 4/26/00, AT&T successfully completed the Wireless tracking stock IPO, selling 360 million shares at $29.50 per share, raising $10.6 billion in needed capital for AT&T. AT&T's Wireless tracking stock IPO "closed" on 5/2/00 in New York City and AT&T received $10.6 billion. ***The same day***, 5/2/00, AT&T released its disappointing 1stQ 00 results – results it had been concealing while waiting for the Wireless tracking stock IPO to be completed. AT&T shocked the markets by revealing that due to the serious problems in AT&T's Concert joint venture and Business Services long-distance voice and data transmission operations, several large corporate long-distance customers had indicated they were going to terminate or had terminated their long-distance service with AT&T. This, combined with the revenues lost due to the 99 loss of the FTS 2000 and BP Amoco contracts, meant that AT&T's vitally important Business Services long-distance voice and data transmission operations would not achieve the level of revenue growth and profit performance that had been forecast by AT&T and that, as a result, AT&T's overall revenue growth rate and profit performance would also be reduced.

24. AT&T's 1stQ 00 results and the associated problems with AT&T's Business Services unit were not publicly revealed until 5/2/00 – ***21 working days after the close of the 1stQ 00, i.e.,***

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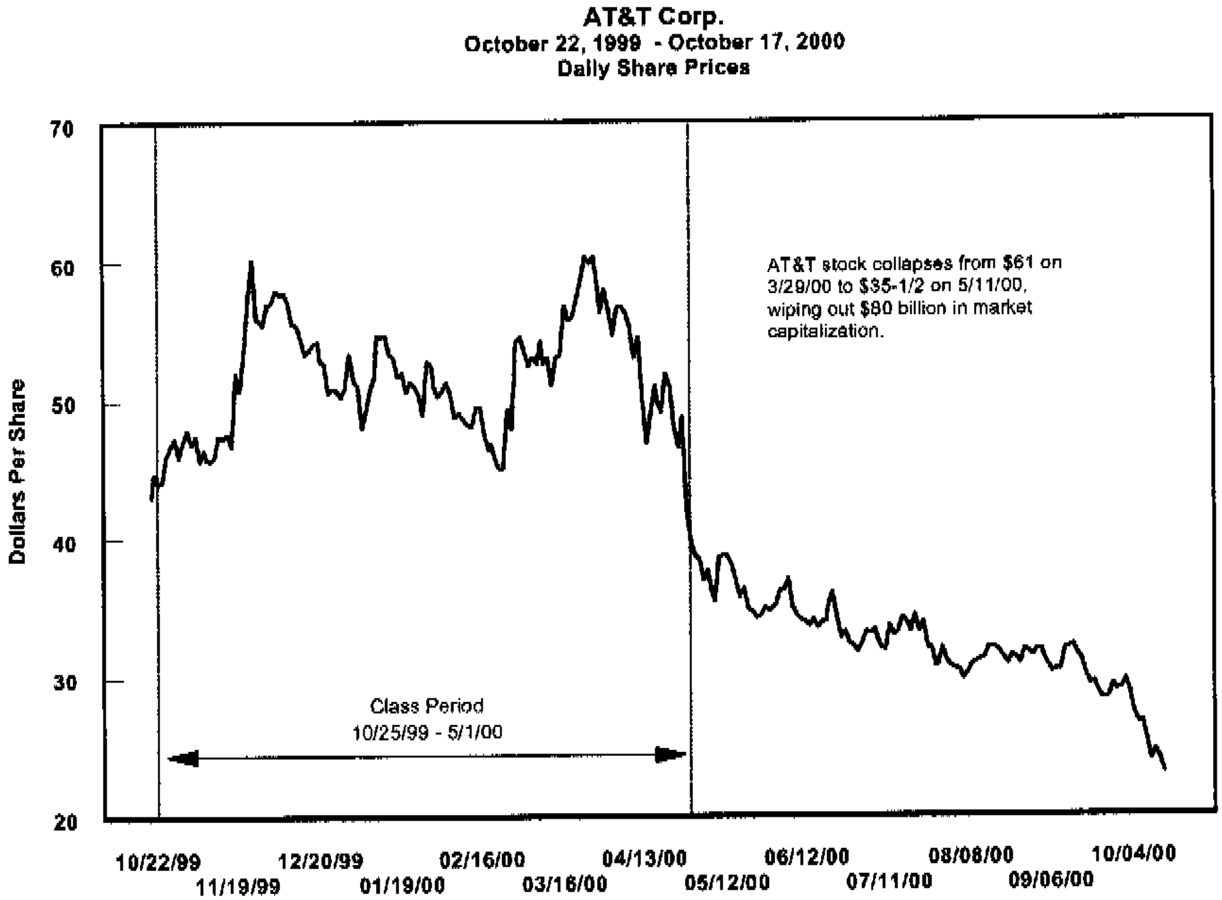
4 AT&T's prospectus for its Wireless tracking shares acknowledged that the price of the Wireless tracking shares could be affected by the performance of AT&T's other business units:

> Holders of AT&T common stock, AT&T Wireless Group tracking stock and Liberty Media Group tracking stock will all be common shareholders of AT&T, ***and will be subject to risks associated with an investment in a single company*** and all of AT&T's businesses, assets and liabilities. ***Financial effects arising from one group that affect AT&T's consolidated results of operations or financial condition could, if significant, affect the combined results of operations or financial position of the other groups or the market price of the class of common shares relating to the other groups.***

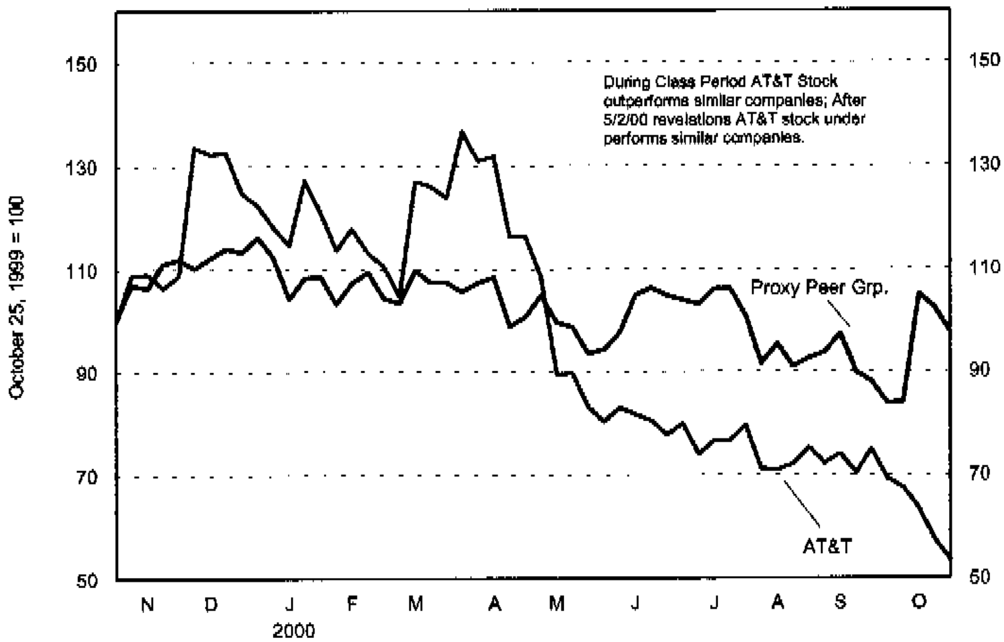
3/31/00! ***That was the largest number of working days past the close of a 1stQ that AT&T took to report its 1stQ results in at least 10 years***! The average number of days required for completion and release of AT&T's 1stQ results over the past 10 years has been 13.4 days, *i.e.*, here 4/18-19/00. ***AT&T's top executives deliberately concealed and delayed the release of AT&T's 1stQ results until 5/2/00, so AT&T could complete the huge IPO of AT&T's Wireless tracking stock and in the hope that it could get AT&T stock to trade at $57 or above until closing the MediaOne acquisition.***

25. ***Analysts and investors reacted to these shocking revelations with a vengeance. AT&T's stock collapsed, falling from $48-13/16 on 5/1/00 to $41-1/8 on 5/2/00 – a 16% decline on astonishing volume of 64.75 million shares, one of the largest one-day price declines on the largest one-day trading volume for AT&T common stock in AT&T's history as a publicly traded company! AT&T's stock, which traded as high as $61 on 3/29/00, fell to as low as $35-1/2 on 5/11/00 – a staggering wipeout of over $80 billion in shareholder market capitalization in just over one month. This stunning collapse of AT&T's stock is shown below***:



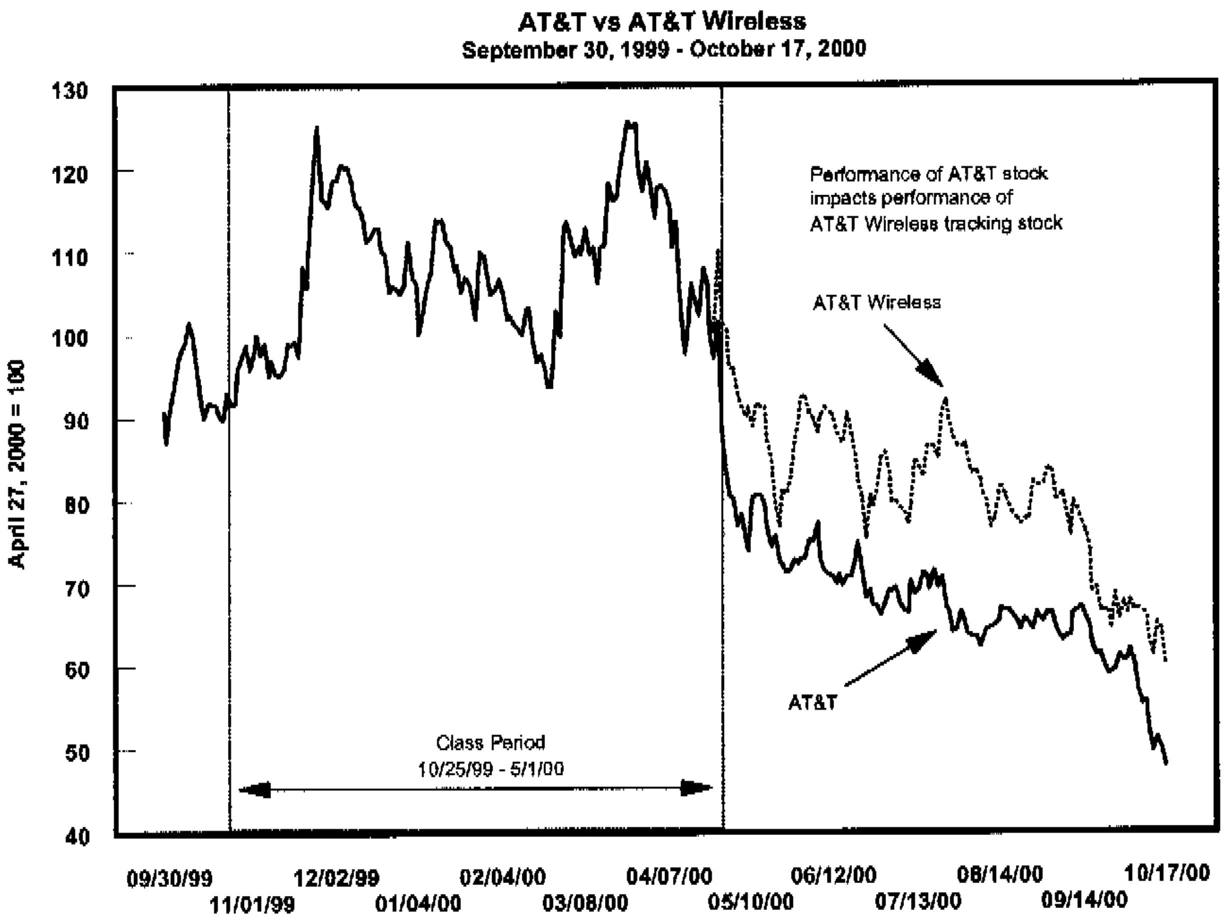
26. As a result of defendants' false and misleading statements, AT&T stock sharply outperformed peer group stocks during Class Period, before collapsing on the revelations of 5/2/00. The performance of AT&T's stock was largely due to company-specific events and information, not market forces:

AT&T Corp.
vs. Proxy Peer Group (1)
October 25, 1999 - October 17, 2000



(1) Equally weighted group consisting of BEL, GTE, SBC, USW, HKT, WCOM, FON, VOD, CMCSA & CVC.

27. The AT&T Wireless tracking stock which had been sold on 4/26/00 at $29.50 also collapsed, falling to as low as $18-1/16 after the revelations of 5/2/00. The collapse of the AT&T Wireless tracking stock and the nearly perfect correlation (about 85%) between the market price of AT&T's common stock and AT&T's Wireless tracking stock are shown below:



The dependence of AT&T's Wireless tracking stock on the performance of AT&T's common stock was noted in a 5/20/00 *National Post* article entitled "AT&T Wireless Fizzles Right After Record IPO," which stated:

> AT&T Wireless is still under AT&T's control. ***That means if something bad happens to AT&T, AT&T Wireless gets hit too. And guess what? That's what happened when AT&T lowered its earnings outlook for the year on May 2, citing erosion in long-distance profits. In the trading session immediately after the forecast, AT&T ... dropped 14% to US$41.88, while AT&T Wireless dropped 9% to US$32.25.***

28. According to *The Wall Street Journal*, AT&T's 5/2/00 conference call revealing this debacle "***left many analysts dismayed***" as Armstrong admitted, "***I do wish that the forecasts we made ... had been more accurate.***" Analysts were furious over this deception by AT&T. One said, "***This was a weak quarter, and fundamentals will remain weak ....***" Another analyst wrote, "***This is a major disappointment versus management's repeated claims ... of being a high-growth company ....***" Another stated, "***We are downgrading shares of T [on] ... lower-than-expected near-term value***

recognition from the Wireless Group IPO .... After successive downward revisions to growth expectations in Business Services ... the operational challenges that AT&T faces in making the change from a cost cutting story to a revenue growth story are more daunting than we had originally expected and could get worse before they get better." Another wrote, "*The violent reaction in the stock was probably a function of both new information and surprise timing. Since AT&T provided detailed 2000 financial guidance in December 1999, a shortfall in the first three months of 2000 was unsettling.*"

29. During AT&T's 5/2/00 conference call, Rick Roscitt, the head of AT&T's Business Services unit, ***admitted*** that in 2/00 – ***long before any disclosure of problems in AT&T's Business Services unit*** – the problems there were so severe that AT&T was already engaged in a significant internal restructuring of that unit, including replacing several top managers, to try to overcome the problems which had arisen there. According to Roscitt, AT&T ***had shuffled too many people too fast across accounts, had broken relationships and was re-deploying people back into sales where they had been before as fast as it could and was hiring 600 additional people for this unit as fast as it could***! Roscitt said:

> [F]rankly, ***the mid-1999 reconfiguration of our high-end sales channel had more impact than we anticipated for several reasons....[W]e realigned the high-end sales team to put a much more – more of an emphasis on data over the voice business further causing a resource realignment as I said that was larger than anticipated. But we quickly recognized these problems*** .... The second challenge we faced was something that was an event earlier in history, in early 1999 we announced that we had lost the FTS 2000 government contract. And, ***while that happened as an event in early '99, the revenue impact as that is being implemented will spread throughout sequential quarters in the full year 2000, so we have a negative growth rate there.***
>
> * * *
>
> In February 2000, we went through a fairly significant restructure of the AT&T business services organization ... ***to react to some of the situations I outlined and frankly to put more accountability in individual leaders' hands....*** [W]e've overhauled the ***entire failed leadership team ....***
>
> * * *
>
> Ken Fishow ... will now lead all of AT&T's business services. Sales has been in place since mid-February. ***Doing that has made significant changes already in the leadership team ....*** In terms of hiring we are adding something in the range of 600 additional data and IP skilled people as fast as we can hire and deploy, and we are deploying staff people without replacement from our headquarter's location into field

sales, people primarily who had been in sales before, who are reassigning back to sales marketplace.

* * *

It's not an industry issue, we really shuffled too many people too fast across accounts, broke a few relationships and, frankly ... did not have our eyes squarely focused on it. ***We changed out that leadership team in a pretty dramatic way....*** So, it's ... not a particular industry, it is a set of accounts where we, frankly, ***did not pay enough attention to the high-end and didn't have enough management focus on it.***

Later, based on discussions with Roscitt and Armstrong, Merrill Lynch wrote:

[M]anagement continues to emphasize the likely drawn out nature of a material recovery.... Note that AT&T's problems in Business Services are focused in the larger accounts, which account for 40% of divisional revenues. Management's assessment, after the fact, is that cost reductions applied to this large account function were "misapplied," unfortunately at a time (around the turn of the year) when the transfer of multinational accounts to Concert was causing a churn in sales people and a reallocation of accounting responsibilities. ***Elite business contracts lost, or new contracts not won, over this period cannot be won back quickly due to the typical industry three-year contract period.***

The New York Times later reported concerning the 5/2/00 revelations that:

AT&T dropped its bomb on the company's investors. AT&T said its operations would grow more slowly and earn less this year than the company had previously led the market to expect.... ***Worst of all, the company said that its unit that sells communications services to business customers, which had been one of its bastions of strength, would miss its previous growth target because it had dropped the ball with some of AT&T's biggest accounts.***

The reaction was swift and harsh. The company's shares ... skidded $7.0625, shaving more than $25 billion from AT&T's market value. ***And the shares did not bounce back. They continued to slide the next day. And the day after that. And the day after that.***

30. On 5/4/00, *The Wall Street Journal* stated "***AT&T's disclosures have angered many analysts and investors, who complain the company knew about these problems for months but didn't make them public. Some note that the disclosures came only after AT&T's initial public offering of its wireless business.***" Analyst Jana Harris, employed at a pension fund whose largest holding is AT&T, as reported in a *Bloomberg News* article issue on 5/2/00, "***questioned the timing of the warning***":

"I wonder why they didn't make us aware of the problems they were having before now. My strong gut feeling is they wanted the wireless offering to go off well," Harris said. "A lot of people feel misguided or somewhat deceived."

According to *The New York Times*:

> [T]he manner and timing of the May 2 announcement ***left a bad taste for many investors and analysts.***
>
> Just three business days before AT&T delivered its bad news, the new stock meant to track the company's wireless business, ***whose offering brought AT&T a $10.6 billion windfall***, began trading.
>
> ***In the days and weeks leading up to the offering, AT&T executives led by John D. Zeglis, AT&T's president, had crisscrossed the country touting the new wireless shares to investors. And in the course of those discussions, it does not appear that Mr. Zeglis gave even a hint of the problems that AT&T was about to announce, leading some investors to worry that perhaps they had been manipulated.***
>
> "Some people said: 'Hey, I just met with Zeglis. What's that about?'" said one communications analyst, on condition of anonymity. Had AT&T delayed the announcement of the bad news to avoid tainting the wireless offering, whose ticker symbol is AWE? What would that say about AT&T's communications in the future?

Armstrong did not deny that AT&T had concealed its Business Services problems during the Wireless tracking stock Roadshow, rather he said:

> "***We didn't think it was relevant to the AWE offering ....***"

31. On 5/4/00, *The Wall Street Journal* reported:

> ***AT&T's Business Unit Admits Mistakes***
>
> * * *
>
> ***The head of AT&T Corp.'s giant Business Services unit acknowledged a series of mistakes....***
>
> "There are some issues that, frankly, we could have and should have performed better on," said Rick Roscitt ... the third president of AT&T Business Services in the past 15 months.
>
> ***As the biggest single unit within AT&T, Business Services is emerging as ground zero for mounting concern about the company's prospects, particularly because AT&T Chairman C. Michael Armstrong has targeted the unit for aggressive growth.*** Tuesday, AT&T lowered its revenue growth target for business services to 8% from the earlier 9% to 11% for the year.
>
> ***This may not sound like a big change, but many analysts were caught off guard by a slew of problems at the unit because much of the rest of the telecommunications industry is enjoying double-digit growth in sales of data, Internet and voice to corporate clients....***
>
> ***AT&T's disclosures have angered many analysts and investors, who complain the company knew about these problems for months but didn't make them public. Some note that the disclosures came only after AT&T's initial public offering of its wireless business....***

> ... *[S]ome of those problems occurred when AT&T transferred 300 top-ranking corporate clients to AT&T's joint venture ..., Concert, late last year, and lost some customers in the process.* The transfer occurred as AT&T was making job cuts among its account representatives, and shifting 1,200 big global accounts to what it calls its "growth unit," where companies no longer have their own representatives.
>
> This lay the groundwork for losing some big clients, said company officials. *"We couldn't really cover them. We had account managers spread too thin," said AT&T's Mr. Roscitt. "We woke up and realized that we disrupted more relationships than we cared to."*
>
> * * *
>
> AT&T suffered another blow last year when it lost a crucial government contract ... called FTS 2000 ... [which is] so big that MCI WorldCom is counting on it bringing in $750 million in revenue over the next four years. MCI WorldCom also snagged a big AT&T customer last year, BP Amoco PLC, for a multiyear contract for at least $650 million.
>
> * * *
>
> *Eric Strumingher, an analyst at PaineWebber Inc. ... said AT&T rivals are enjoying data growth of more than 30%, while AT&T's data and Internet growth remains in the midteens. "This is not an industry issue; this is an AT&T-specific issue,"* he said.

32. *Fortune's* 5/29/00 edition contained an article entitled "More Not-So-Good-News for AT&T," which stated:

> The Company recently pared back growth estimates of the business services unit to 8% this year, down from earlier forecasts of 9% to 11%, and lowered 2000 earnings estimates for the entire company. Wall Street slammed the stock accordingly, sending it down 26%.
>
> *A spokeswoman [for] the company ... blamed the woes in the business segment on AT&T's failure to serve some of its biggest customers. When AT&T transferred its biggest multinational accounts to Concert, its joint venture with British Telecom, account reps didn't know which entity the customers belonged to. The result: Customers were confused and inked future contracts with others. These corporate accounts matter – about half the company's revenues and top-line earnings come from corporate sales.*

33. On 10/2/00, *The Industry Standard* reported:

> One of Armstrong's first moves was to shed thousands of employees – always a quick and dirty way to please Wall Street. But those losses, coupled with the hundreds of salespeople who left AT&T to join the Concert joint venture with BT, left the company with gutted, underperforming service and sales groups. Customers fled, and projections were revised for the business services group; the whole company had to restate its estimates. *"We're still suffering from the shortfall," says [John Petrillo, AT&T's VP of Strategy and Development]. "But we've been chastened and we're remorseful about it."*

34. According to the 9/00 edition of *Bloomberg Markets*:

> On May 2, three business days after AT&T Wireless went public, Armstrong informed analysts that AT&T's annual earnings would be lower because revenues from long distance were deteriorating faster than he had anticipated. He said the decline in the consumer long-distance business would be 5-7 percent instead of 3-5 percent. He explained that new revenues from his huge investments weren't kicking in as fast as he'd expected to make up the difference. Says CFO Noski, who joined the company after the projections had been made, "***I think the planning and forecasting process last year may not have been as rigorous as it might have been.***"
>
> Armstrong lowered estimates for business services growth .... ***He admitted AT&T had mismanaged some major business accounts in its Concert joint venture with British Telecom. In the shuffle, competitors like WorldCom and Sprint snapped up some of AT&T's biggest accounts. AT&T lost a $650-million contract for BP Amoco and a government contract worth $3 billion to WorldCom.***

35. ***Roscitt has admitted to the media that he "knew" that the Business Services unit's revised and increased growth rates announced in 12/99 were false when he saw the 1/00 results*** – of which he "quickly" informed Armstrong. ***However, he, Armstrong and AT&T's other top executives decided not to disclose this information then, but rather, to conceal it while waiting for the 2/00 and 3/00 results which, as they knew they would be, were even worse.*** Thus they made no disclosure, waiting to complete the AT&T Wireless offering. Armstrong has reportedly stated:

> "***Where the problem happened, I'm accountable, but I don't operate quite at that level,***" Mr. Armstrong said. "***The relationships, the administrative support, the skill coverage in those accounts was not carefully managed and we lost the kind of proposing, anticipating and customer-relationship role. And we've got to redo that. And you don't do that in weeks or months. It's going to take quarters.***"

36. The undisclosed problems afflicting AT&T's business during the Class Period were serious and pervasive. Since the revelations of 5/2/00, they have worsened. On 10/25/00, AT&T announced it was cutting its forecasted 00 EPS to $1.66 due to Business Services' poor performance – very weak revenue growth (2.5%) which would continue during 01 resulting in ***falling earnings for this key segment.*** Due to the serious cable upgrade/broadband build-out delays and overruns and the inability to integrate AT&T's prior acquisitions, AT&T's strategy of transforming itself into a global telecommunications conglomerate, delivering bundled services, had failed. ***As a result, during 10/00, Armstrong announced AT&T was abandoning the bundling approach by which it had accumulated $62 billion in debt, breaking itself up into four separate companies via project "Grand Slam"!*** However, this reversal of strategy and split-up was, in fact, an admission that the Armstrong-led

revival of AT&T was an utter failure and was, in fact, a thinly disguised step to substantially cut, if not eliminate, AT&T's common stock dividend of $.88 – ***the final humiliation of Armstrong and insult to AT&T's public shareholders.*** Analysts cut the AT&T 00 EPS forecast to just $1.65-$1.75 from the $2.10-$2.15 forecast during the Class Period. AT&T slashed the growth forecast for its Business Services unit to just 6% – about half of its previously forecasted levels. The press reported:

- *The Wall Street Journal*-10/26/00:

> ***The company ... disclosed ... that the "systemic decline" of ... business customers, the core of the company, is steeper than previously thought.***
>
> * * *
>
> AT&T said that for the first time ever it will cut its dividend, with the combined payout for all four of the new units winding up "substantially less" than AT&T's current annual dividend of 88 cents a share....
>
> ***People familiar with the matter say the dividend will be slashed by more than half its current level.***
>
> * * *
>
> "***It's hard to escape the feeling that a corporate funeral took place today,***" said Ken McGee, an analyst with Gartner Group. "It's really the end of an icon ***and no matter how they try to put a positive spin on it, it's the death of [a] corporate giant.***"
>
> Investors concurred. They ignored AT&T's claims that AT&T's pieces are worth far more than the stock market is valuing the company. Wall Street focused on the poor revenue report, sending the stock down 13% to $23.37, down $3.50 a share ....
>
> * * *
>
> ***Mr. Armstrong said he and Chuck Noski, AT&T's chief financial officer, began talking about a breakup about nine months ago .... "We start talking about it in February or March and we brought it to the board in April....***"
>
> * * *
>
> [Armstrong claimed the break-up was part of his ongoing plan] ***[b]ut nobody was buying that view this time around,*** especially Wall Street and AT&T's once-loyal investors. And many observers speculated that Mr. Armstrong and his lieutenants won't be around to see his latest plan completed.
>
> "What the market said today is ***that Armstrong's strategy in any form whatsoever – even breaking up the company – continues to be a failure.*** And the market voted with its feet" today by driving down AT&T shares, said Brian Bruce, director of global investments for PanAgora Asset Management Inc. in Boston, which has held AT&T shares.

"Today's announcement is simply window dressing" and yet another example of how Mr. Armstrong "continues to be incredibly ineffective," he said.

- *The New York Times*-10/26/00

If only AT&T worked as hard at telecommunications as it does at financial engineering, maybe investors would treat it with more respect. ***The newest breakup of AT&T is a desperate effort to make Wall Street happy, something the company seems to think it can accomplish by dishing out lots of investment banking fees while reducing dividends paid to its shareholders.***

- *Los Angeles Times* – 10/26/00:

In a dramatic signal that AT&T's three-year effort to remake itself into a one-stop telecommunications marketplace has failed, the company said Wednesday it will disassemble itself into three separate companies ....

* * *

Armstrong's master plan was to turn Ma Bell into an integrated provider of local, long-distance and wireless phone calling, along with cable television and Internet services. Over the next two years he spent about $100 billion to buy two huge nationwide cable systems to carry most of those services into the home.

* * *

*"**Frankly, if AT&T was performing up to its original forecasts ... talk about restructuring would not exist,**"* said Jack Grubman, analyst at Salomon Smith Barney.

Sales growth in AT&T's business services segment is projected to be half of what was originally anticipated ....

* * *

*"**This is an amazing strategic about-face for AT&T,**"* said one prominent industry observer.

- *The Industry Standard* – 11/6/00:

For those who enjoy watching monoliths disintegrate, AT&T's crack-up has been a gratifying spectacle.

Last week CEO Michael Armstrong, who took over the telecommunications giant in 1997 determined to build a single shop for voice, data and multimedia transmissions, announced that the company would split into four separate companies ....

* * *

Indeed, the breakup represents a comeuppance for Armstrong, whose dream of creating the reigning communications conglomerate – a sort of GE of the telecommunications industry, providing voice and data transmission over a vast unified network – is now officially dead....

The AT&T name will reside with AT&T Business Services, which offers Internet hosting and data networking to corporate customers. Though lucrative (it generated $25 billion in revenue in 1999), ***that business has suffered from the effects of layoffs among its sales staff, mandated shortly after Armstrong took over the company.***

- *Business Week* – 11/6/00:

Salomon Smith Barney analyst Jack B. Grubman downgraded AT&T's stock ..., his second downgrade of the year. "***The business is melting down,***" says Grubman.

Armstrong is under tremendous pressure to fix AT&T's flagging stock price. The company's shares have tumbled 62% from their peak last year, to $24, and are trading at 20% less than when Armstrong was hired three years ago.

* * *

The operation that sells to businesses has its work cut out for it. ***After bungling the sales force reorganization earlier this year, the business has a lot to prove.***

- *Newsweek* – 11/6/00:

As you doubtless know, AT&T unveiled a complex plan last week to turn itself into three separate companies with four parts sporting a total of six different stocks. What you may not know is that a major motivation was AT&T's worry that its falling stock price made it vulnerable to a hostile takeover....

The biggest winners in AT&T's proposed breakup, dubbed Project Grand Slam, are investment bankers, lawyers and other parasites, who stand to reap World Series-class fees. The losers are those who depend on AT&T's formerly reliable dividend for income. AT&T's dividend had never been cut since the company started paying it in 1881, a period that includes several financial panics, two world wars and the Great Depression.... AT&T ... can't keep shelling out $3.3 billion of dividends a year....

The Street reacted by knocking 19 percent off AT&T's already depressed share price in two days. That decline probably has more to do with the warning AT&T issued Wednesday – it said revenues and profits for the next 15 months will be lower than forecast – than with the breakup and dividend cut. But it shows how far Armstrong's Street cred[ibility] has dropped. Back in March, when Wall Street considered Armstrong a visionary genius, news of AT&T's shuffling stocks around would have sent the stock to the moon. ***Witness the 25 percent, four-day rise last November, when news leaked that AT&T might issue a "tracking stock" tied to its wireless business. But Armstrong was a hero then; now, he's a bum.***

- *Business Week* – 2/5/01:

Armstrong's efforts to buy his way out of the mess by acquiring cable giants Tele-Communications Inc. and MediaOne Group have saddled this company with an alarming $62 billion in debt....

In a ***desperate attempt*** to rescue AT&T, Armstrong announced on Oct. 26 that he would break the 123-year old flagship of the American telecom industry into four pieces.... ***But investors and analysts balked.*** The company's stock was whacked 18%,

falling to 23% the day the restructuring was announced. And it ended 2000 down 66%, at 17-1/4 ....

... Now, Armstrong is making his last stand.... ***[H]is ambitious attempt to restore Ma Bell to her former glory by making it the most important communications company of the Digital Age lies in tatters.***

* * *

Business Week has learned that the company has run into substantial trouble in developing new cable-technology equipment. The result is that the cost of signing up customers for local telephone service over the cable network will continue to be $600 per home for another year or two instead of dropping to $400 per home in 2001, as Armstrong had promised investors. AT&T confirmed the delay.

* * *

The two units that provide long distance have problems beyond evaporating revenues. ***AT&T Business, which gets more than half of its $29 billion in sales from long distance, lost corporate customers in late 1999 because of a chaotic sales-force reorganization.***

* * *

The tale of how Armstrong started down this path begins further back than most would suspect. ***It was in November, 1999, that he first considered busting up the company....*** Armstrong had spent the previous two years trying to rebuild AT&T into a juggernaut that could supply soup-to-nuts communications services. His $105 billion in cable acquisitions were designed to allow him to sell consumers high-speed Net access and local telephone service over the cable-television network, along with AT&T's existing long-distance, wireless, and data services for corporations.

* * *

Grand Slam was a strikeout. ***Many investors felt Armstrong was conceding that his acquisition spree was a bust. "Clearly, this is a complete reversal of strategy," says telecom analyst Adam Quinton of Merrill Lynch & Co.***

* * *

Brian Hayward, manager of the $2.4 Invesco Telecommunications Fund, sold his remaining shares in AT&T after Armstrong announced Grand Slam.... "***They've been telling us up until now that bundled service is the way of the industry, and now they're telling us these companies are ready to be broken apart," he says. "It insulted my intelligence.***"

Elsewhere, the 2/5/01 *Business Week* article listed among Armstrong's "missteps":

BOTCHED CUSTOMER SERVICE. ***When AT&T moved large corporate customers to its Concert joint venture with British Telecom, many AT&T salespeople quit and service deteriorated. Customers defected, contributing to AT&T's poor financial performance last year....***

- *Institutional Investor* – 1/01:

> Not long ago C. Michael Armstrong was a Wall Street hero, boldly leading AT&T Corp. into the New Economy. In little more than a year, he spent $92 billion to buy two huge cable companies to become the broadband pipe through which the company reached customers.
>
> ***Now Armstrong is under siege ... after warning in May that earnings would slow dramatically, its shares shed 60 percent.***
>
> ***So much for creating value.***
>
> * * *
>
> ***What an about-face for Armstrong. He spent two years turning AT&T into the largest cable operator in the country. Armstrong's idea was to use cable to deliver phone service, high-speed Internet access and interactive television. Ma Bell's business and long-distance units were supposed to provide strong cash flows until the cable acquisitions paid off. Not so: Long-distance returns are declining even more rapidly than expected, and the growth of the business services unit unexpectedly tailed off after it lost several big customers....***

37. Jack Grubman, the most influential Wall Street telecommunications analyst, wrote on 10/25/00:

> ***Frankly, we do view this restructuring as a reversal of strategy....*** AT&T made a big deal about creating an integrated communications company selling bundled services to consumers and business across various distribution channels. That is being abandoned ....

38. ***AT&T stock continued to fall, ultimately to as low as $16-1/2 by 12/00 – its lowest price in years (wiping out $154 billion in market capitalization from the stock's Class Period high) – as AT&T's business problems not only persisted but got worse. In late 00, AT&T halted its equipment purchases for the cable upgrade/broadband build-out, laid off 2,000 cable employees, reduced its estimates of wireless new subscriber growth in 01 and began to try to sell off several of its cable operations.*** It was also revealed that the AT&T Wireless unit's "churn" rate was ***the worst in the industry***, due to widespread customer dissatisfaction caused by terrible service problems and huge billing problems and errors. On 1/29/01, AT&T reported horrible 00 operating EPS of just $.88, far below the $2.10-$2.15 forecast during the Class Period, and has indicated to analysts that its 01 EPS will fall even further, to as little as $.20. It was revealed that AT&T's Business Services unit continued to deteriorate and that its 01 revenues and profits would decline. From the 1stQ 00 through the 4thQ 00, revenues from AT&T's Business Services operations actually declined and AT&T's

overall operating EPS plunged in 00 to just $.88 – a sharp decline from AT&T's 99 operating EPS of $1.74. This is shown below:

1999
(in thousands, except EPS)

	03/31	06/30	09/30	12/31	Year
Revenues	$14,117	$15,752	$16,333	$16,398	$62,600
Business Service Revenues	$ 6,448	$ 6,764	$ 7,056	$ 7,212	$27,480
Net income	$ 1,076	$ 1,588	$ 1,633	$ 1,153	$ 5,450
EPS	$.38	$.49	$.50	$.36	$1.74

2000

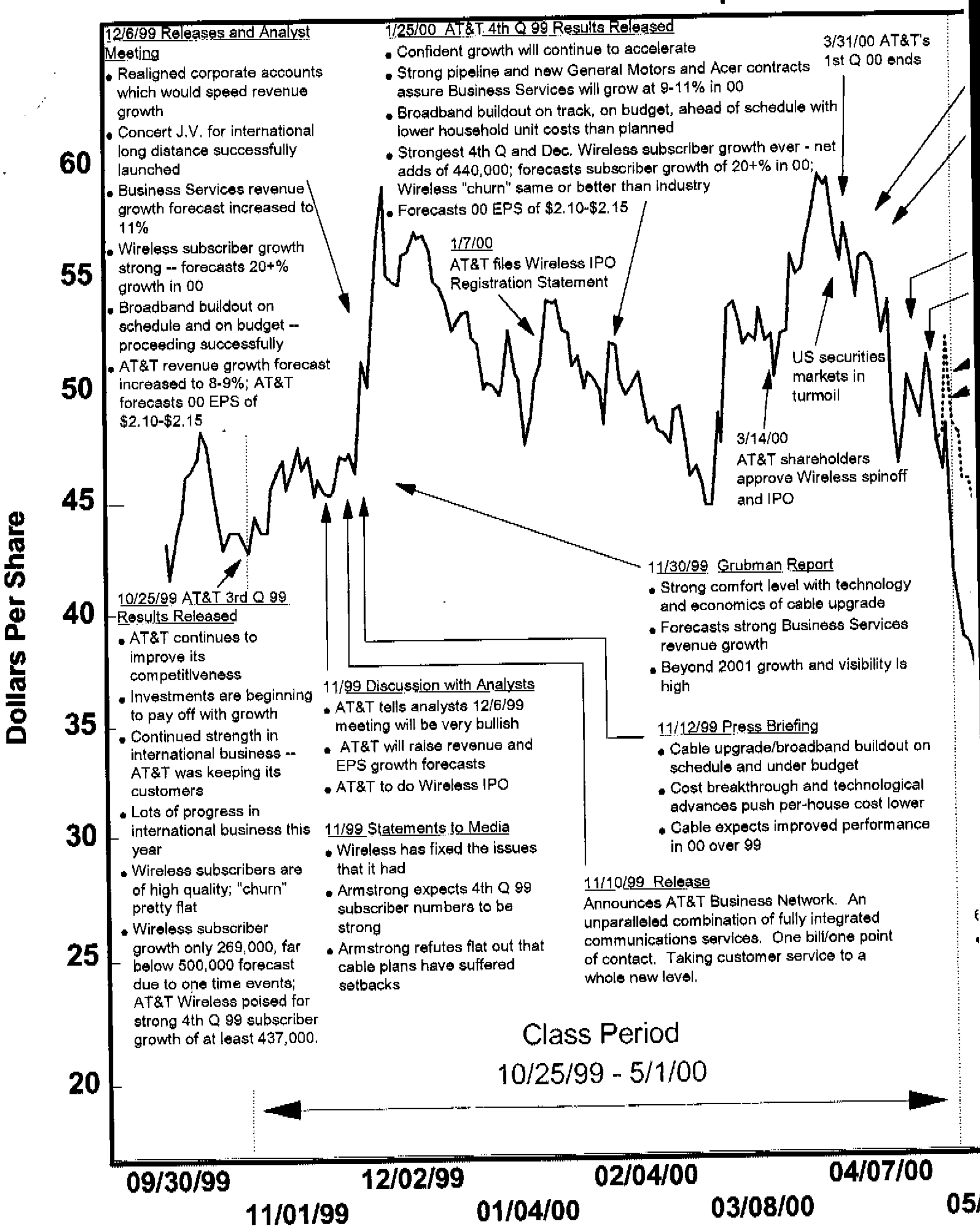
	03/31	06/30	09/30	12/31	Year
Revenues	$15,901	$16,221	$16,975	$16,884	$65,981
Business Service Revenues	$ 7,136	$ 7,147	$ 7,108	$ 7,097	$28,488
Net income	$ 1,741	$ 1,745	$ 1,319	$(1,700)	$ 3,181
EPS	$.54	$.53	$.35	$(.45)	$.88

According to the 1/30/01 *New York Times*:

> AT&T reported a huge fourth-quarter loss yesterday, burdened by write-offs from its high-speed Internet holdings and the erosion of revenue from long-distance operations.
>
> The company, which plans to split into four operations, also lowered its forecast for the first quarter.
>
> * * *
>
> Accompanying expenses from ballooning debt and other costs associated with AT&T's foray into cable, revenue from the company's consumer long-distance operations continued to decline, falling 14.7 percent, to $4.3 billion, in the quarter. The recent entry of local phone companies into the consumer long-distance business have made the industry far more competitive than it was a few years ago.
>
> "Plainly put, the fourth quarter was lousy ... it's not clear when things will get better," said Kevin Calabrese, a telecommunications analyst at Argus Research.
>
> * * *
>
> The company ended the year with $31.9 billion of short-term debt and $33.1 billion of long-term debt, for a total of $65 billion, ***an 81 percent increase from the***

AT&T Even

September 30, 1999 -



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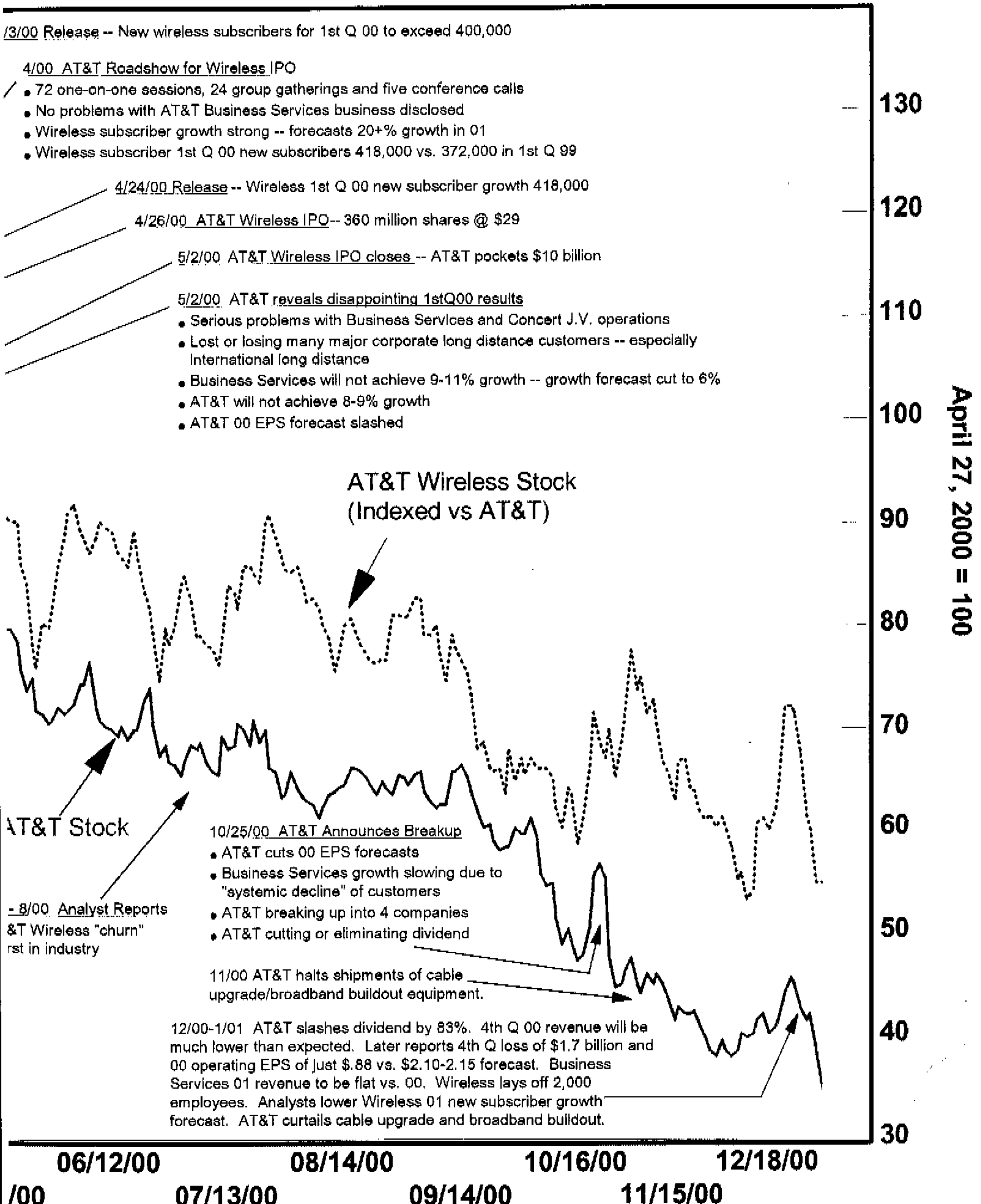
cember 21, 2000



previous year. Interest expenses nearly doubled in the fourth quarter, to $1.03 billion from $577 million.

"There is no question that this is an unacceptable level," said Philip Olesen, an executive director of UBS Warburg who analyzes telecommunications debt. "AT&T needs to show investors how it can remove itself from significant debt pressure."

39. AT&T's results for 00 were a disaster, resulting in downgrades of AT&T's coveted credit ratings:

- On 11/10/00, Fitch lowered its ratings of AT&T's senior unsecured debt from AA- to A-.
- On 11/15/00, Moody's lowered its ratings on AT&T's long-term senior unsecured debt from A2 to A1. Subsidiaries of AT&T (including TCI and MediaOne) also had their ratings reduced.
- On 11/17/00, Fitch lowered its ratings of AT&T's guaranteed notes from AA- to A+.
- Also, in 11/00, Standard & Poor's downgraded AT&T's debt from AA- to A.

40. AT&T was successful in a key part of its scheme – it was able to complete the IPO of 360 million shares of AT&T's Wireless tracking stock at $29.50 per share raising $10.6 billion. However, AT&T was not successful with respect to the other part of its scheme, as it could not get the MediaOne acquisition closed prior to the 5/2/00 revelations. Thus, because of the collapse of AT&T's stock to as low as $35-1/2 per share, after the revelations of 5/2/00, AT&T had to pay the $3.6 billion cash guarantee on the MediaOne acquisition when it closed in early 6/00.

41. The events alleged in this Complaint are summarized and graphically presented on the fold-out chart presented here:

JURISDICTION AND VENUE

42. The claims asserted arise under §§10(b) and 20(a) of the Securities Exchange Act of 1934 ("1934 Act") and Rule 10b-5. Jurisdiction is conferred by §27 of the 1934 Act. Venue is proper pursuant to §27 of the 1934 Act, as AT&T has an executive office here where Armstrong worked and made many of his false statements from. Thus, false statements were made here, Armstrong lives here and maintains his AT&T office here and acts giving rise to the violations complained of occurred here.

PARTIES

43. (a) Plaintiff The New Hampshire Retirement System is a trusteed public pension plan located in New Hampshire, covering fire, police, teachers, state and local public employees, which purchased 103,200 shares of AT&T common stock during the Class Period and was damaged thereby, as shown in a certification previously filed with the Court.

(b) Plaintiff International Brotherhood of Electrical Workers Local 98 is a trusteed pension plan, which purchased 4,500 shares of AT&T common stock during the Class Period and was damaged thereby, as shown in a certification previously filed with the Court.

(c) Plaintiffs Mohammed and Mauline Karkanawi purchased 78,391 shares of AT&T common stock during the Class Period and were damaged thereby, as shown in a certification previously filed with the Court.

(d) Plaintiff Secure Holdings, Inc. purchased 33,000 shares of AT&T common stock during the Class Period and was damaged thereby, as shown in a certification previously filed with the Court.

(e) Plaintiff Robert Baker purchased 154,883 shares of AT&T common stock during the Class Period and was damaged thereby, as shown in a certification previously filed with the Court.

44. Defendant AT&T is headquartered in Basking Ridge, New Jersey and New York City, New York. AT&T's common stock trades in an efficient market on the NYSE. Defendant AT&T controlled each of the individual defendants who were employees of AT&T and is liable under §20(a) of the 1934 Act.

45. (a) Defendant C. Michael Armstrong ("Armstrong") is Chairman and Chief Executive Officer of AT&T. By reason of his positions with AT&T, Armstrong was a controlling person of AT&T and is liable under §20(a) of the 1934 Act.

(b) Defendant Charles H. Noski ("Noski") is Senior Executive Vice President and Chief Financial Officer of AT&T.

(c) Defendant Richard R. Roscitt ("Roscitt") is President of AT&T Business Services.

(d) Defendant John D. Zeglis ("Zeglis") is Chairman and Chief Executive Officer of AT&T Wireless and a director of AT&T.

(e) Defendant Daniel E. Somers ("Somers") was Chief Financial Officer of AT&T until 12/99 and thereafter President of AT&T Broadband.

(f) The options to purchase AT&T stock granted to the individual defendants are set forth below:

Name	Date of Grant	Number of Shares	Exercise Price
Armstrong	01/30/98*	450,000	$42.10
	01/29/99	450,000	$59.87
	05/20/99	123,410	$58.78
Noski	12/10/99	86,000	$57.34
	12/10/99	1,317,126	$57.34
Somers	01/30/98*	99,000	$42.10
	01/29/99*	424,500	$53.87
	11/16/99	100,000	$46.96
	11/16/99	22,000	$46.96
Roscitt	01/30/98*	51,000	$42.10
	06/16/98*	225,000	$40.95
	01/29/99*	60,000	$59.87
	11/16/99	200,000	$46.96

Zeglis	01/30/98*	157,500	$42.10
	01/29/99*	667,500	$59.87

* Adjusted for 3-for-2 split in 4/99.

SCIENTER AND SCHEME ALLEGATIONS

A. The Scheme to Inflate AT&T's Stock Price

46. Each defendant is liable for making false statements or for failing to disclose adverse facts while selling or purchasing AT&T stock ***or*** for participating in a fraudulent scheme by which AT&T attempted to push AT&T stock to up over $57 per share and keep it there, so AT&T could successfully complete the AT&T Wireless tracking stock IPO on favorable terms to it and raise billions of dollars of new capital it desperately needed and close the MediaOne acquisition and avoid paying the $3.6 billion cash guarantee due if AT&T stock fell below $57. As detailed in ¶45(f), the individual defendants also had recently been granted options to purchase hundreds of thousands of shares of AT&T stock at between $40.95-$59.87 per share – options that were worth millions of dollars to each of them if AT&T stock could be pushed up above and kept above those prices until those options vested and the individual defendants could exercise those options, sell the stock and pocket the net proceeds.

47. AT&T was successful in one key part of its scheme – it was able to complete the IPO of 360 million shares of AT&T's Wireless tracking stock at $29.50 per share raising $10.6 billion, compared to the $24 per share AT&T Wireless tracking stock fell to after AT&T revealed the adverse information about its core business long-distance operations and AT&T's growth on 5/2/00. However, AT&T was not successful with respect to the other part of its scheme, as it could not get the MediaOne acquisition closed prior to the 5/2/00 revelations. Thus, because of the collapse of AT&T's stock to as low as $35-1/2 per share following the revelations of 5/2/00, AT&T had to pay the $3.6 billion cash guarantee on the MediaOne acquisition when it closed in early 6/00.

B. Armstrong Fires Thousands of Employees, Gutting Business Services

48. Armstrong became the Chairman and CEO of AT&T in late 97. Because AT&T's growth had slowed dramatically, it was widely perceived that AT&T's future was endangered by the lack of a viable growth strategy in the rapidly evolving telecommunications industry and that, as a

result, its stock would continue to be a very poor performer. This caused widespread concern among AT&T's shareholders. Armstrong was picked for the top job at AT&T to remedy this situation.

49. Upon Armstrong's arrival at AT&T, he implemented dramatic steps to try to accelerate AT&T's revenue growth and improve its profitability, hoping to change AT&T from a staid, low-growth long-distance carrier into a diversified, rapidly growing telecommunications giant. Armstrong's strategy employed a combination of huge cost cuts – achieved via the layoff of thousands of white-collar management employees – and an extraordinarily expensive acquisition spree to diversify AT&T into high-growth areas, such as cable and broadband. By mid-99, Armstrong had eliminated billions of dollars of overhead – cutting over 20,000 white-collar positions – and spent over $140 billion on several acquisitions (Teleport Communications, TeleCommunications, Inc., IBM's Global Network and MediaOne) by having AT&T issue hundreds of millions of new shares of its common stock and incur billions of dollars of additional debt. AT&T also had embarked on a massive multi-billion dollar project to upgrade the antiquated cable TV systems it had purchased – to convert them to broadband technology – so AT&T could delivered bundled telecommunications services to consumers and businesses. AT&T also announced the formation of a huge joint venture with BT, called Concert, which was to be the core of AT&T's international long-distance business and global growth strategy.

C. The Business Services Fiasco

50. Armstrong initially attempted to boost AT&T's profitability by making huge reductions in force, via layoffs or induced retirements, mostly of experienced and highly paid white-collar employees, to drastically cut AT&T's overhead. In the Spring of 98, Armstrong's first big reduction in force resulted in 15,000 experienced white-collar departures – ***over 40% of which were experienced sales and service personnel from AT&T's Business Services unit***, *i.e.*, 6,000 employees. In fact, so many of these Business Services unit employees left that Armstrong terminated the early retirement offer to them a year before it was due to expire. During late 98 and early 99, Robert Annunziata, the head of AT&T's Business Services unit, repeatedly warned Armstrong that this loss of experienced sales and service personnel in the Business Services unit ***was already having a very negative impact on customer service and relations with AT&T's most***

important, largest and most profitable corporate long-distance customers, was hurting AT&T's competitiveness and that failure to hire additional competent sales and service personnel for Business Services would result in a continued deterioration of this situation and the loss of large profitable international corporate customers – badly hurting Business Services' competitive position, revenues and profits.

51. During 98 and 99, the operations of Business Services were further hampered by repeated executive turnover – due to having four heads of Business Services in less than two years – resulting in discontinuity, management confusion and rivalry leading to lack of focus and execution, exacerbating the already increasing customer dissatisfaction and departures. In 2/99, his warnings and advice to Armstrong ignored, Annunziata left, replaced as head of Business Services by Michael Keith – a selection which infuriated Rick Roscitt, head of AT&T's Solutions unit, a consulting software and outsourcing business aligned with Business Services. A Keith-Roscitt rivalry and fight commenced immediately and resulted in significant diversion of energy and time and a lack of required attention to the ever-escalating operational problems of Business Services – including its diminished competitiveness.

52. As a result of the defection of large numbers of Business Services' managers and supervisors during 98 and executive uncertainty and conflict, by early 99 Business Services was already experiencing sharply increased complaints from major corporate customers and dissatisfaction due to the decreased service levels and reduced sales activities. Then, in early 99, due to very disappointing results for TCI, AT&T's large new cable unit, including large cash flow shortfalls, Armstrong faced a tremendous challenge – he had to keep AT&T's profits and cash flow up while he tried to successfully integrate and fix this huge acquisition, upon which so much of his personal prestige now depended. In mid-99, in order to make up for these TCI shortfalls, Armstrong forced Business Services (AT&T's largest and most profitable unit) to ***increase*** its profit margins and cash flows by another huge cost-cutting effort which required the firing or forced retirement of over 2,000 more experienced sales and service white-collar employees, on top of the 6,000 such employees eliminated in 98, to cut another $2 billion out of AT&T's cost structure. Armstrong was warned that these huge personnel cuts on top of the 98 cuts would further exacerbate Business Services' already

serious operational problems – leading to increased customer service problems, further sales problems, the loss of major corporate customers and reduced growth for the Business Services unit. Rejecting these warnings, Armstrong insisted that his cost-cuts be made – ***"it's your problem,"*** he told the Business Services unit's top executives.

53. In mid-99, the Business Services managers learned that, due to the creation of Concert, AT&T's new joint venture with BT to save large international corporate customers and which was to become operational in late 99, ***some 300-500 of AT&T's largest corporate customers would be transferred to Concert***. This meant the revenues and profits of these huge accounts would leave AT&T ***and no longer impact the compensation of the managers of AT&T's Business Services unit***. As a result, AT&T's Business Services unit began ignoring these very important customers. For instance, in the New York office of Business Services, its largest office, ***the top managers issued instructions to employees to cut services to the customers they had learned were going to Concert.*** Top managers told employees that since these customers were going to Concert in late 99, they were to "***ignore them***" and "***not answer their phone calls,***" to thus lessen the costs expended on these soon-to-be-lost-to-Concert customers, boosting the New York Business Services unit's results in the short run and the managers' bonuses. When employees challenged the ethics and wisdom of this conduct, ***they were told to do what they were told.***

54. These escalating operational problems in the Business Services unit were badly exacerbated by the formation of the Concert joint venture in the 2nd half of 99. In addition to the serious service problems caused by the New York office of Business Services refusing to service large corporate customers designated for transfer to Concert, in the Fall of 99, AT&T transferred approximately 300+ sales and customer service representatives to Concert to service Concert's new customers, ***without taking the time and steps to recruit or adequately train capable replacements for them in AT&T's Business Services unit.*** At the same time, Business Services received some 1,200 new large business accounts to form a new "high-growth" unit. This loss of 300+ experienced service and sales representatives, plus 1,200 new corporate accounts, further exacerbated the serious sales and service problems and shortfalls already affecting the Business Services unit.

55. By the Fall of 99, as a result of the foregoing, a huge crisis had developed in AT&T's Business Services unit – executive in-fighting, a lack of adequate, experienced sales and service personnel and increasing losses of important corporate customers. Roscitt finally won his power struggle with Keith and Keith was dispatched to the AT&T Wireless operations to help pull off the highly important IPO of that tracking stock. However, by now the effects of the decimation of the Business Services unit's experienced managers and supervisors had had an irreversible negative impact on customer relations, service levels and sales activities. Important, large and very profitable business long-distance customers were infuriated with the lack of service, sales to new and existing customers had collapsed and Business Services customers were canceling or not renewing long-distance service contracts in droves – ***cancellations that Armstrong knew would have a very adverse impact on Business Services' results beginning with the 1stQ and 2ndQ 00, when existing contracts with canceling and non-renewing Business Services customers expired.***

56. As a result of the loss of experienced sales and service personnel and infrastructure cut-backs, extremely serious service problems had developed in the Business Services unit by the Fall of 99:

- Customers with severe problems and complaints could not get AT&T representatives on the phone for 15-20 minutes – leading to customer outrage and cancellations of AT&T long-distance service by important international corporate customers.

- When attempting to order new or expanded services, customers could not get sales representatives to pay attention to them; ordering new or expanded services took weeks or months instead of days, leading to a loss of sales and revenues and customer defections.

- Obtaining bids for routine contracts (new or renewals) took weeks instead of days, resulting in customer defections.

- Due to the elimination of experienced customer service representatives, large business customers with questions/complaints were forced to call an 800 number instead of their personal service representative, as had been the case when Business Services had adequate personnel, and after a 15-20 minute wait these important corporate customers now reached a "pool" of inexperienced sales representatives unfamiliar with the customers' historical relationships with AT&T and unable to adequately respond to or process customer difficulties. Large corporate customers were infuriated over this decline in service and canceled their AT&T long-distance service.

- By the 3rdQ and 4thQ 99, AT&T also began forcing large corporate customers accustomed to personal service by experienced and highly competent AT&T employees to report service issues to AT&T by e-mail, a process that resulted in 7- to 9-day delays in even an initial response to key customers' complaints, again

> infuriating these important customers accustomed to personal service, resulting in customer defections.

AT&T has lost a large number of important customers, costing it many millions in revenue, including Pepsi, Chase Manhattan, Bank of New York, Super Value, Inc., Paper Mart and G&A Sales.

57. By 10/99, the accumulated impact of the service and sales problems with AT&T's Business Services ***had reached crisis proportions***. AT&T had established a "critical situation" unit within Business Services (involving top AT&T executives, including Armstrong) to deal with serious threatening and unresolved complaints of important corporate long-distance customers, which unit was receiving ***over 20 very serious complaints a month to try to deal with***. Complaints did not go to the critical situation unit until ***after repeated efforts to resolve the customer complaint had failed*** and then only upon the recommendation of the manager of the critical situation unit, so serious from a corporate perspective were these complaints. Thus, these were truly critical problems with huge customers, so serious they threatened continuation of AT&T's service to those customers. The only exception to this procedure was important corporate customer complaints ***made to Armstrong directly***, who then referred them to the Business Services' critical situation unit – ***a situation which was occurring with increasing frequency*** in the Fall of 99, as the operations of Business Services collapsed and the departure of highly important AT&T corporate customers rose to unprecedented levels.

58. The specific areas of AT&T Business Services impacted by the reorganization negatively affected a "great deal" of the internal organizations that built and maintained AT&T's operating support systems. Prior to the reorganization, one of those systems might have had a hundred employees supporting it, but after the reorganization, there were only about 10 left to support the system. All the systems after the reorganization "ran until they fell apart." ***There was an "all hands meeting" that occurred during the AT&T Business Services reorganization in late 99, where employees were informed that AT&T had experienced a "dramatic drop in revenue" from its business long-distance operations, which had adversely impacted the entire Company***.

59. The extent of these problems in AT&T's most important business unit cannot be overstated. By 3/00, Armstrong had admitted ***over 50% of AT&T's high-end corporate customers***

had suffered such serious sales or service problems that it resulted in a revenue "shortfall" for those customers! To try to remedy this very serious problem, which resulted in a slashing of Business Services' 00 growth forecast from 11% to just 6% and destroyed AT&T's overall 00 growth forecast, AT&T put together a task force of 300 experienced corporate managers nationally to go into Business Services to shore up sales and services to resource this key AT&T unit – a task force known as "Raiders of the Lost Revenue."

60. During AT&T's 5/2/00 conference call, Rick Roscitt, the head of AT&T's Business Services unit, admitted that in 2/00 – long before any disclosure of problems in AT&T's Business Services unit – AT&T was engaged in a significant internal restructuring of that unit, including replacing several top managers, to try to overcome the problems which had arisen there. According to Roscitt, AT&T ***had shuffled too many people too fast across accounts, had broken relationships and was re-deploying people back into sales where they had been before as fast as it could and was hiring 600 additional people for this unit as fast as it could***! Roscitt said:

> [F]rankly, ***the mid-1999 reconfiguration of our high-end sales channel had more impact than we anticipated for several reasons....[W]e realigned the high-end sales team to put a much more – more of an emphasis on data over the voice business further causing a resource realignment as I said that was larger than anticipated. But we quickly recognized these problems*** .... The second challenge we faced was something that was an event earlier in history, in early 1999 we announced that we had lost the FTS 2000 government contract. And, ***while that happened as an event in early '99, the revenue impact as that is being implemented will spread throughout sequential quarters in the full year 2000, so we have a negative growth rate there.***
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> In February 2000, we went through a fairly significant restructure of the AT&T business services organization ... ***to react to some of the situations I outlined and frankly to put more accountability in individual leaders' hands***. We now have a data and IP business that's combined under one leadership entity with Kathleen Early leading, [and] ***we've overhauled the entire failed leadership team and establish[ed] an overall head of AT&T business services sales*** ....
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> Ken Fishow ... will now lead all of AT&T's business services. Sales has been in place since mid-February. ***Doing that has made significant changes already in the leadership team*** .... In terms of hiring we are adding something in the range of 600 additional data and IP skilled people as fast as we can hire and deploy, and we are deploying staff people without replacement from our headquarter's location into field sales, people primarily who had been in sales before, who are reassigning back to sales marketplace.
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> ***It's not an industry issue, we really shuffled too many people too fast across accounts, broke a few relationships*** and, frankly ... did not have our eyes squarely focused on it. We changed out that leadership team in a pretty dramatic way.... So, it's ... not a particular industry, it is a set of accounts where we, frankly, ***did not pay enough attention to the high-end and didn't have enough management focus on it.***

Later, based on discussions with Roscitt and Armstrong, Merrill Lynch wrote:

> [M]anagement continues to emphasize the likely drawn out nature of a material recovery. With ... evidence from the Qwest numbers that their service bundle is gaining greater acceptance and penetration amongst large enterprise customers.... ***Note that AT&T's problems in Business Services are focused in the larger accounts, which account for 40% of divisional revenues. Management's assessment, after the fact, is that cost reductions applied to this large account function were "misapplied," unfortunately at a time (around the turn of the year) when the transfer of multinational accounts to Concert was causing a churn in sales people and a reallocation of accounting responsibilities. Elite business contracts lost, or new contracts not won, over this period cannot be won back quickly due to the typical industry three-year contract period.***

The New York Times later reported concerning the 5/2/00 revelations that:

> ***AT&T dropped its bomb on the company's investors.*** AT&T said its operations would grow more slowly and earn less this year than the company had previously led the market to expect.... ***Worst of all, the company said that its unit that sells communications services to business customers, which had been one of its bastions of strength, would miss its previous growth target because it had dropped the ball with some of AT&T's biggest accounts.***
>
> The reaction was swift and harsh. The company's shares ... skidded $7.0625, shaving more than $25 billion from AT&T's market value. ***And the shares did not bounce back. They continued to slide the next day. And the day after that. And the day after that.***

61. On 5/4/00, *The Wall Street Journal* reported:

> ***AT&T's Business Unit Admits Mistakes***
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> ***The head of AT&T Corp.'s giant Business Services unit acknowledged a series of mistakes....***
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> "There are some issues that, frankly, we could have and should have performed better on," said Rick Roscitt ... the third president of AT&T Business Services in the past 15 months.
>
> ***As the biggest single unit within AT&T, Business Services is emerging as ground zero for mounting concern about the company's prospects, particularly because AT&T Chairman C. Michael Armstrong has targeted the unit for aggressive growth.*** Tuesday, AT&T lowered its revenue growth target for business services to 8% from the earlier 9% to 11% for the year.
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> ***This may not sound like a big change, but many analysts were caught off guard by a slew of problems at the unit because much of the rest of the telecommunications industry is enjoying double-digit growth in sales of data, Internet and voice to corporate clients....***

> ***AT&T's disclosures have angered many analysts and investors, who complain the company knew about these problems for months but didn't make them public. Some note that the disclosures came only after AT&T's initial public offering of its wireless business....***
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> ***... [S]ome of those problems occurred when AT&T transferred 300 top-ranking corporate clients to AT&T's joint venture ..., Concert, late last year, and lost some customers in the process.*** The transfer occurred as AT&T was making job cuts among its account representatives, and shifting 1,200 big global accounts to what it calls its "growth unit," where companies no longer have their own representatives.
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> This lay the groundwork for losing some big clients, said company officials. ***"We couldn't really cover them. We had account managers spread too thin," said AT&T's Mr. Roscitt. "We woke up and realized that we disrupted more relationships than we cared to."***
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> AT&T suffered another blow last year when it lost a crucial government contract ... called FTS 2000 ... [which is] so big that MCI WorldCom is counting on it bringing in $750 million in revenue over the next four years. MCI WorldCom also snagged a big AT&T customer last year, BP Amoco PLC, for a multiyear contract for at least $650 million.
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> Eric Struminger, an analyst at PaineWebber Inc. ... said AT&T rivals are enjoying data growth of more than 30%, while AT&T's data and Internet growth remains in the midteens. ***"This is not an industry issue; this is an AT&T-specific issue,"*** he said.

62. *Fortune's* 5/29/00 edition contained an article entitled "More Not-So-Good-News for AT&T," which stated:

> The Company recently pared back growth estimates of the business services unit to 8% this year, down from earlier forecasts of 9% to 11%, and lowered 2000 earnings estimates for the entire company. Wall Street slammed the stock accordingly, sending it down 26%.
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> ***A spokeswoman [for] the company ... blamed the woes in the business segment on AT&T's failure to serve some of its biggest customers.*** When AT&T transferred its biggest multinational accounts to Concert, its joint venture with British Telecom, account reps didn't know which entity the customers belonged to. The result: Customers were confused and inked future contracts with others. These corporate accounts matter – about half the company's revenues and top-line earnings come from corporate sales.

63. On 10/2/00, *The Industry Standard* reported:

> One of Armstrong's first moves was to shed thousands of employees – always a quick and dirty way to please Wall Street. ***But those losses, coupled with the hundreds of salespeople who left AT&T to join the Concert joint venture with BT, left the company with gutted, underperforming service and sales groups. Customers fled, and projections were revised for the business services group; the whole company had to restate its estimates. "We're still suffering from the shortfall," says [John Petrillo, AT&T's VP of Strategy and Development]. "But we've been chastened and we're remorseful about it."***